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West Lindsey District Council
The Entrepreneurial Council

PR.10 14/15
Policy and Resources Committee
Date 24 July 2014

Subject: Annual Report on the Treasury Management Service and Actual Prudential and Treasury Indicators 2013/2014

Report by:	S151 Officer, Director of Resources
Contact Officer:	Tracey Bircumshaw Group Accountant 01427 676560 Tracey.Bircumshaw@west-lindsey.gov.uk
Purpose / Summary:	The annual treasury report is a requirement of the Council's reporting procedures. It covers the treasury activity during 2013/14 and the actual Prudential Indicators for 2013/14.

RECOMMENDATION(S):

That Members note the Annual Treasury Management Report for 2013/14 and recommend to Council the approval of the actual 2013/14 Prudential and Treasury Indicators contained therein.

IMPLICATIONS

Legal:

None arising from this report.

Financial : FIN/26/15

None arising from this report.

Staffing :

None arising from this report.

Equality and Diversity including Human Rights :

None arising from this report.

Risk Assessment :

None arising from this report.

Climate Related Risks and Opportunities :

None arising from this report.

Title and Location of any Background Papers used in the preparation of this report:

Call in and Urgency:

Is the decision one which Rule 14.7 of the Scrutiny Procedure Rules apply?

i.e. is the report exempt from being called in due to urgency (in consultation with C&I chairman)	**Yes**		**No**	**x**

Key Decision:

A matter which affects two or more wards, or has significant financial implications	**Yes**		**No**	**x**

Background

The 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 indictors 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 meeting held 4 March 2013
- a Mid-Year (minimum) Treasury Update Report – Council meeting held 7 November 2013
- an Annual Treasury Management Report following the year describing the activity compared to the strategy (this report).

In addition, the Policy and Resources Committee has received quarterly Treasury Management update reports on 5 September 2013 and 20 February 2014.

The regulatory environment places responsibility on Members for the review and scrutiny of treasury management policy and activities. The 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.

The 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 Governance and Audit Committee (Annual Investment Strategy) and Policy and Resources Committee (Capital Programme, Mid-Year and Annual Report) before they were reported to the full Council. Member training on treasury management issues was undertaken during the year in November 2013 in order to support Members' scrutiny role.

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 Original £'000	2013/14 Revised £'000	2013/14 Actual £'000
Capital expenditure	2,458	3,533	2,632	2,251
Capital Financing Requirement:	1,842	1,825	1,825	1,745
Gross Borrowing (Finance Leases)	782	760	760	683
Gross Investments				
• Longer than 1 year	1,373	1,373	0	0
• Under 1 year	14,694	11,730	15,621	15,929
Total	**16,067**	**13,103**	**15,621**	**15,929**
Net borrowing/ (investments)	**(15,285)**	**(12,343)**	**(14,861)**	**(15,246)**

Other prudential and treasury indicators are to be found in the main body of this report. The S151 Officer also confirms that borrowing was only undertaken for a capital purpose and the statutory borrowing limit (the Authorised Limit) was not breached.

The financial year 2013/14 continued with a challenging investment environment as of recent years, namely low investment returns.

1. Introduction

1.1 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 if the Council has borrowed in relation to this indebtedness, and the impact on investment balances
- Summary of interest rate movements in the year
- Detailed debt activity
- Detailed investment activity

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

2.1 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
- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

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

General Fund	2012/13 Actual £'000	2013/14 Original £'000	2013/14 Estimate £'000	2013/14 Actual £'000
Capital expenditure	**2,458**	**3,533**	**3,650**	**2,251**
Resourced by:				
Capital receipts	1,104	1,255	1,581	153
Capital grants / Contributions	505	1,408	1,119	1,224
Capital Reserves	0	0	0	0
Revenue	634	805	713	780
Finance leases	215	65	237	94
Unfinanced capital expenditure	**0**	**0**	**0**	**0**

3. The Council's Overall Borrowing Need

3.1 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 table 2.2), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

3.2 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 sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the Government, through the Public Works Loan Board [PWLB] or the money markets), or utilising temporary cash resources within the Council.

3.3 **Reducing the CFR** – The Council's underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision (MRP), to reduce the CFR. This is effectively a repayment of borrowing. This differs from the treasury management arrangements, which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

3.4 The total CFR can also be reduced by:

- the application of additional capital financing resources (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

3.5 The Council's 2013/14 MRP Policy (as required by CLG Guidance) was approved as part of the Treasury Management Strategy Report for 2013/14 on 4 March 2013.

3.6 The Council's CFR for the year is shown below, and represents a key prudential indicator. It includes leasing schemes on the balance sheet, which increase the Council's borrowing need. No borrowing is actually required against these schemes as a borrowing facility is included in the contract.

Capital Financing Requirement	31 March 2013 Actual £'000	31 March 2014 Budget £'000	31 March 2014 Revised £'000	31 March 2014 Actual £'000
Opening balance	**1,887**	**1,842**	**1,842**	**1,842**
Adj for previous year financing	(12)	172	172	1
Add adjustment for the inclusion of on-balance sheet leasing arrangements	215	65	65	94
Less Finance Lease repayments/MRP	(248)	(254)	(254)	(192)
Closing balance	**1,842**	**1,825**	**1,825**	**1,745**

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

3.8 **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 year (2014/15) and the next two financial years. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs in 2013/14. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator with the gross borrowing position reflecting outstanding finance leases on vehicles and equipment.

	31 March 2013 Actual £'000	31 March 2014 Original £'000	31 March 2014 Revised £'000	31 March 2014 Actual £'000
Gross borrowing position	**782**	**760**	**760**	**683**
CFR	**1,842**	**1,825**	**1,825**	**1,745**

3.9 **The Authorised Limit** – the authorised limit is the "affordable borrowing limit" required by section 3 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.

3.10 **The Operational Boundary** – the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary is acceptable subject to the authorised limit not being breached.

3.11 **Actual financing costs as a proportion of net revenue stream** – this indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

3.12 **Incremental impact of capital investment decisions on Council Tax. -** This indicator identifies the revenue consequences associated with the capital investment decisions, i.e. the repayment of finance leases, the loss of investment interest, net of projected revenue income from the capital investment on the Council Tax.

	2013/14 £'000
Authorised Limit	**5,000**
Maximum gross borrowing position	**760**
Operational Boundary	**760**
Average gross borrowing position	**733**
Financing costs as a proportion of net revenue stream	**0.37%**
Incremental impact of capital investment decisions on Council Tax	**£1.40**

4. Treasury Position as at 31 March 2014

4.1.1 The Council's debt and 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 both through Member reporting detailed in the summary, and through officer activity detailed in the Council's Treasury Management Practices. At the beginning and the end of 2013/14 the Council's treasury position was as follows:

Actual borrowing position	31 March 2013		31 March 2014	
	Principal £'000	Average Rate	Principal £'000	Average Rate
Fixed Interest Rate Debt	0	0%	0	0%
Variable Interest Rate Debt	0	0%	0	0%
Total Debt	**0**	**0%**	**0**	**0%**
Capital Financing Requirement £'000	**1,842**		**1,745**	
Finance lease liabilities £'000	**782**		**683**	
Over/(under) borrowing £'000	**(1,060)**		**(1,062)**	
Bank and Money Market deposits	**31 March 2013**		**31 March 2014**	
	Principal £'000	**Average Rate**	**Principal £'000**	**Average Rate**
Fixed Interest money market and bank deposits	11,165	4.14%	13,729	0.68%
Variable Interest money market and bank deposits	4,902	1.63%	2,200	0.38%
Total Investments/Cash Equivalents	**16,067**	**1.43%**	**15,929**	**1.45%**
Net borrowing position	**(15,285)**		**(15,246)**	

The maturity of the investment portfolio was as follows:

	31 March 2013 Actual £'000	2013/14 Original limits £'000	31 March 2014 Actual £'000
Investments/Cash Equivalents			
Longer than 1 year	1,373	1,373	0
Under 1 year	14,694	9,145	15,929
Total	**16,067**	**10,518**	**15,929**

Note: Excludes bank current account balance.

5. The Strategy for 2013/14

5.1 The expectation for interest rates within the strategy for 2013/14 anticipated low but rising Bank Rates (starting in quarter 1 of 2015), and gradual rises in medium and longer term fixed borrowing rates over 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.

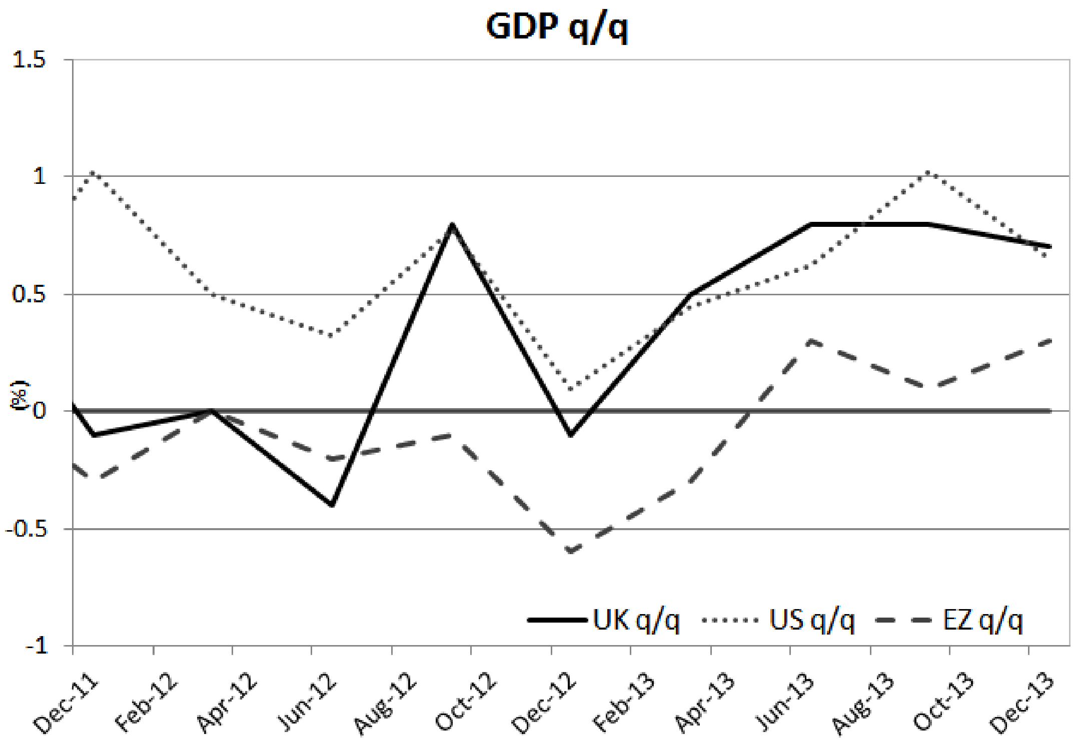
6. The Economy and Interest Rates (Sector Treasury Management Advisors)

6.1 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 had 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.

6.2 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 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.

6.3 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.

6.4 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 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 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.


GDP q/q
1.5
1
0.5
(%) 0
-0.5
-1
UK q/q
US q/q
EZ q/q
Dec-11
Feb-12
Apr-12
Jun-12
Aug-12
Oct-12
Dec-12
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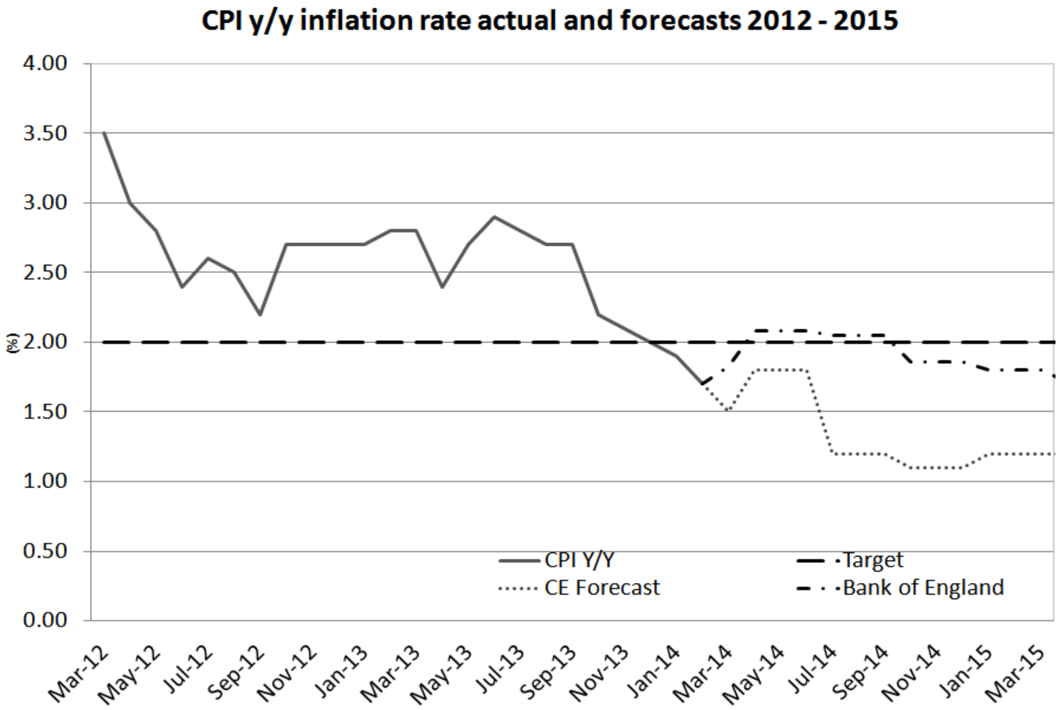
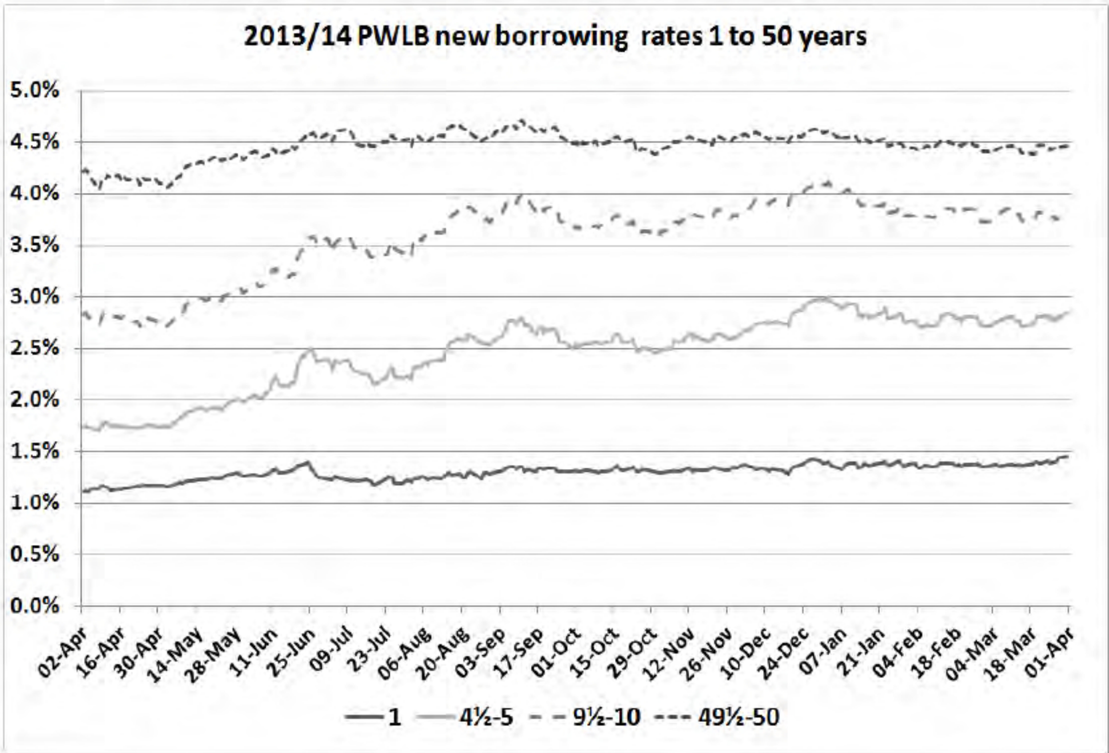
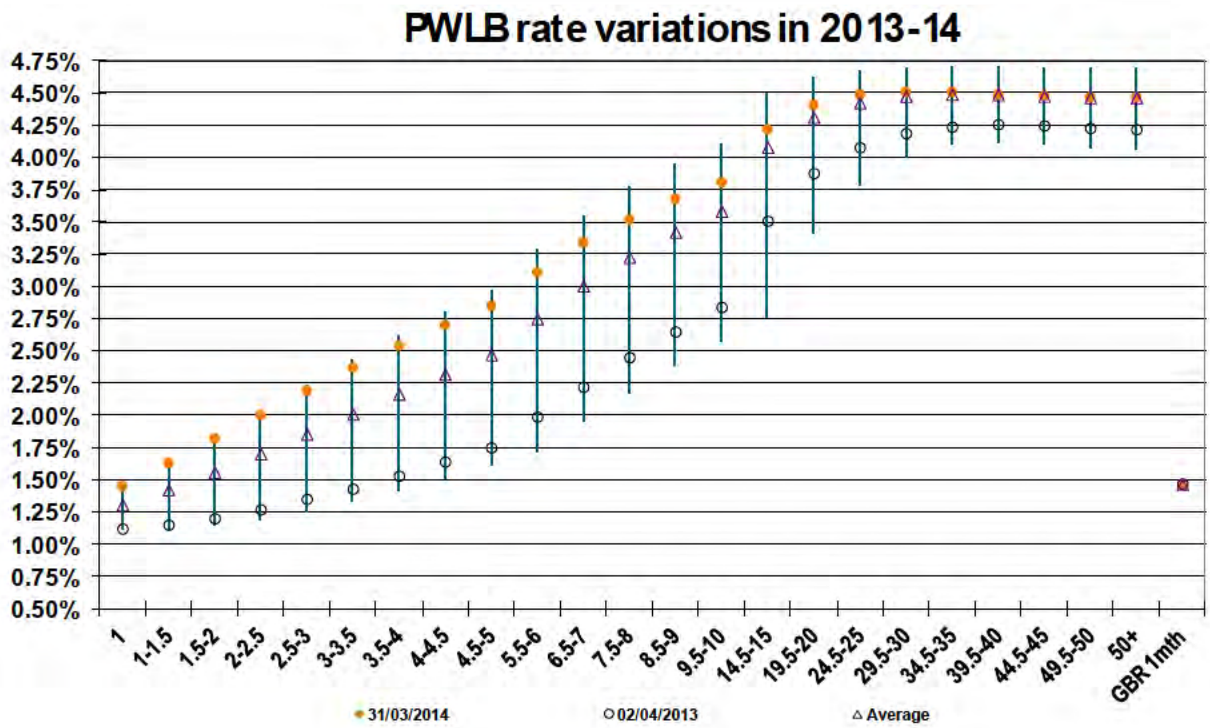
Apr-13
Jun-13
Aug-13
Oct-13
Dec-13


CPI y/y inflation rate actual and forecasts 2012 - 2015
4.00
3.50
3.00
2.50
(%) 2.00
1.50
1.00
0.50
0.00
CPI Y/Y
Target
CE Forecast
Bank of England
Mar-12
May-12
Jul-12
Sep-12
Nov-12
Jan-13
Mar-13
May-13
Jul-13
Sep-13
Nov-13
Jan-14
Mar-14
May-14
Jul-14
Sep-14
Nov-14
Jan-15
Mar-15

7. Borrowing Rates in 2013/14– (Sector Treasury Management Advisors)

7.1 **PWLB borrowing rates –** the graph for PWLB maturity rates below show, for a selection of maturity periods, the high and low points in rates, the average rates, spreads and individual rates at the start and the end of the financial year.

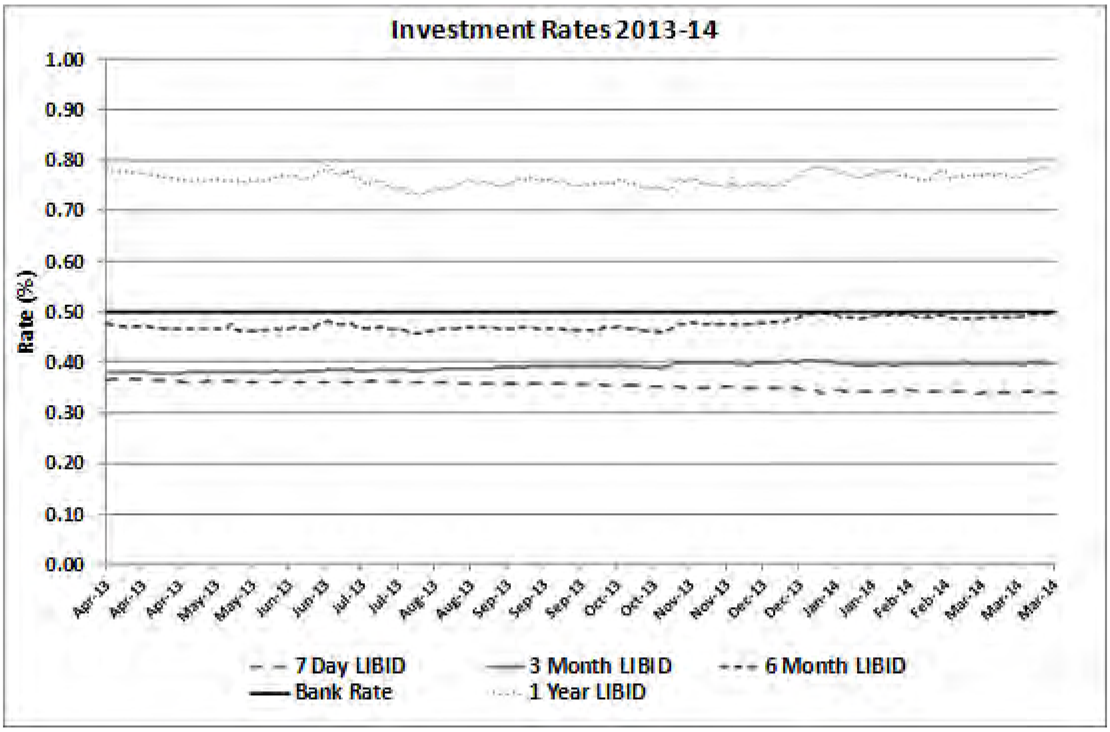




	PWLB borrowing rates 2013/14 for 1 to 50 years								
	1	1-1.5	2.5-3	3.5-4	4.5-5	9.5-10	24.5-25	49.5-50	1month variable
2/4/13	1.120%	1.150%	1.350%	1.530%	1.750%	2.840%	4.080%	4.230%	1.470%
31/3/14	1.300%	1.420%	1.870%	2.190%	2.500%	3.660%	4.450%	4.480%	1.470%
High	1.450%	1.630%	2.230%	2.620%	2.970%	4.100%	4.670%	4.700%	1.480%
Low	1.110%	1.120%	1.250%	1.410%	1.610%	2.580%	3.780%	4.070%	1.450%
Average	1.305%	1.421%	1.853%	2.164%	2.469%	3.584%	4.427%	4.467%	1.466%
Spread	0.340%	0.510%	0.980%	1.210%	1.360%	1.520%	0.890%	0.630%	0.030%
High date	31/3/14	31/3/14	27/12/13	27/12/13	27/12/13	2/1/14	10/9/13	10/9/13	9/4/13
Low date	5/4/13	15/4/13	15/4/13	15/4/13	15/4/13	19/4/13	19/4/13	3/5/13	10/5/13

8. Investment Rates in 2013/14 (Sector Treasury Management Advisors)

8.1 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.



	Money market investment rates 2013/14					
	overnight	7 day	1 month	3 month	6 month	1 year
1/4/13	0.361	0.365	0.371	0.382	0.478	0.784
31/3/14	0.321	0.342	0.363	0.397	0.497	0.786
High %	0.361	0.368	0.371	0.403	0.498	0.790
Low %	0.258	0.338	0.357	0.379	0.457	0.734
Average %	0.347	0.354	0.364	0.391	0.475	0.762
Spread %	0.104	0.029	0.015	0.023	0.041	0.056
High date	1/4/13	2/4/13	1/4/13	24/12/13	31/12/13	24/6/13
Low date	31/12/13	26/3/14	18/3/14	17/4/13	31/7/13	1/8/13

9. Investment Outturn for 2013/14

9.1 **Investment Policy** – the Council's investment policy is governed by CLG guidance, which has been implemented in the annual investment strategy approved by Council on 4 March 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 and equity prices).

The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

9.2 **Resources** – the Council's cash balances comprise revenue and capital resources and cash flow monies. The Council's core cash resources comprised as follows:

Balance Sheet Resources	31 March 2013 £'000	31 March 2014 £'000
Balances	2,327	2,160
Earmarked reserves	10,550	12,293
Provisions	556	462
Usable capital receipts	2,485	2,393
Total	15,918	17,308

9.3 **Investments held by the Council** – the Council maintained an average balance of £18.884m of internally managed funds (excluding Icelandic Bank deposits). The internally managed funds earned an average rate of return of 0.77%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.35%. This compares with a budget assumption of £13.1m investment balances (excluding Icelandic deposits) earning an average rate of 0.93%.

10. Performance Measurement

10.1 One of the key requirements in the Code is the formal introduction of performance measurements relating to investments, debt and capital financing activities. Whilst investment performance criteria have been well developed and universally accepted, debt performance indicators continue to be a more problematic area with the traditional average portfolio rate of interest acting as the main guide. The Council's performance indicators were set out in the Annual Treasury Management Strategy.

10.2 The following performance indicator is measured

- **Investments – Internal returns above the 7 day LIBID rate**
  Performance excluding Icelandic deposits is reported in paragraph 9.3

10.3 Security and liquidity benchmarks are being developed and were introduced for 2013/14. These benchmarks were not exceeded at any point in the year.

- See Appendix A

11. Icelandic Bank Defaults

11.1 As previously reported the Council had the following principal deposits frozen in Icelandic banks:

Bank	Date Invested	Maturity Date	Original Amount Invested £'000	Interest Rate %
Glitnir	07/02/08	06/02/09	1,000	5.45
Heritable Bank	15/07/08	17/10/08	1,000	5.88
Landsbanki	15/07/08	17/10/08	1,000	5.88
Landsbanki	30/07/08	17/10/08	1,500	5.80
Landsbanki	15/08/08	21/11/08	1,500	5.89
Heritable Bank	17/09/08	08/10/08	1,000	5.55
Total			**7,000**	

11.2 The U.K. Government, Local Government Association, administrators and other agencies have continued to work throughout 2013/14 in recovering assets and co-ordinating repayments to all UK councils with Icelandic investments.

11.3 From a total investment of £7m (claim amount £7.252m) the Council has received £6.661m from dividend repayments and sale of investments. There are no further amounts anticipated, however, £0.202m remains held in an Escrow account pending the Supreme Court of Iceland's approval to repatriate these funds.

11.4 In the case of Heritable Bank plc, a significant repayment was made in August 2013, bringing the total repayments to approximately 94%. This is expected to be the last payment, although the final position has yet to be confirmed.

11.5 In February 2014, the Council sold its Landsbanki claim to a third party. In total of £3.724m of the original £4m invested has been received.

11.6 In respect of Glitnir, the Council has received 100% of its claim in full settlement for Glitnir Bank hf. However, an element of the distribution is in Icelandic Kroner which has been placed in an escrow account in Iceland and is earning interest of 4.2% as at 31st March 2014. This element of the distribution has been retained in Iceland due to currency controls currently operating in Iceland and as a result is subject to exchange rate risk, over which the Council has no control.

Security Benchmarking 31 March 2014

Counterparty	Principal	Maturity Date	Rate (not needed for the credit analysis)	Country	Sector Limits	Current Long Term rating (Fitch or equivalent)	Long Term Rating for Table	Remaining Life in Years	Life Per table Equivalent	Historic Risk of default	Weighting
A	B	C	D	E	F	G	H	I	J	K	
Investment Position											
Lloyds Bank	£500,000	18-Aug-14	1.010%	UK	Banks - UK	A	A	0.38	1	0.089%	**£171**
Nationwide Building Society	£5,000,000	17-Apr-14	0.470%	UK	Banks - UK	A	A	0.05	1	0.089%	**£207**
Royal Bank of Scotland	£5,000,000	03-Jul-14	0.950%	UK	Banks - UK	A	A	0.26	1	0.089%	**£1,145**
Lloyds Bank	£500,000	10-Oct-14	0.800%	UK	Banks - UK	A	A	0.53	1	0.089%	**£235**
Ignis - Liquidity Fund	£1,100,000	01-Apr-14		UK	MMF	AAA	AAA	0.00	1	0.000%	**£0**
Insight - Liquidity Fund	£1,100,000	01-Apr-14		UK	MMF	AAA	AAA	0.00	1	0.000%	**£0**
Lloyds Bank	£500,000	19-Jun-14	1.050%	UK	Banks - UK	A	A	0.22	1	0.089%	**£97**
Lloyds Bank	£2,000,000	17-Apr-14	0.750%	UK	Banks - UK	A	A	0.05	1	0.089%	**£83**
New - Glitnir	£202,452		4.200%	Other							
Total	**£15,902,452**				**LIQUIDITY - Weighted Average Life**			**0.12**	**RISK Factors**	**0.012%**	**£1,938**
							WLDC Benchmarks	0.25		0.03%	