

Annual Treasury Outturn Report 2013/14

1 Purpose

- 1.1 The County Council adopts the key recommendations of the Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management in the Public Services: Code of Practice, which includes an annual report on the treasury management strategy after the end of each financial year.

2 Summary

- 2.1 Treasury management in the context of this report is defined as:

“The management of the organisation’s investments and 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.”

- 2.2 This annual report sets out the performance of the treasury management function during 2013/14, to include the effects of the decisions taken and the transactions executed in the past year.
- 2.3 Overall responsibility for treasury management remains with the County Council. No treasury management activity is without risk; the effective identification and management of risk are integral to the County Council’s treasury management objectives.
- 2.4 All treasury activity has complied with the County Council’s Treasury Management Strategy and Investment Strategy for 2013/14, and all relevant statute, guidance and accounting standards. In addition the County Council’s treasury advisers, Arlingclose, provide support in undertaking treasury management activities.
- 2.5 The County Council has complied with all of the prudential indicators set in its Treasury Management Strategy, these are detailed fully in Appendix 1.

3 Economic background

- 3.1 The following Section outlines the key economic themes against which investment and borrowing decisions have been made in the past financial year. At the beginning of the 2013-14 financial year markets were concerned about lacklustre growth in the Eurozone, the UK and Japan. Lack of growth in the UK economy, the threat of a ‘triple-dip’ recession alongside falling real wages (i.e. after inflation) and the paucity of business investment were a concern for the Bank of England’s Monetary Policy Committee. However, the recovery in the UK surprised with strong economic activity and growth. The first quarter of 2014’s year-on-year growth estimate was an increase of 3.1%. Much

of the improvement was down to the dominant service sector, and an increase in household consumption buoyed by the pick-up in housing transactions which were driven by higher consumer confidence, greater availability of credit and strengthening house prices which were partly boosted by government initiatives such as Help-to-Buy.

- 3.2 With new Governor Mark Carney at the helm, the Bank of England unveiled forward guidance in August 2013 pledging to not consider raising interest rates until the International Labour Organisation (ILO) measure of unemployment fell below the 7% threshold. In the Bank's initial forecast, this level was only expected to be reached in 2016. Although the Bank stressed that this level was a threshold for consideration of rate increase rather an automatic trigger, markets began pricing in a much earlier rise than was warranted and, as a result, gilt yields rose aggressively.
- 3.3 CPI fell from 2.8% in March 2013 to 1.6% in March 2014, the lowest rate since October 2009, helped largely by the easing commodity prices and discounting by retailers, reducing the pressure on the Bank to raise rates. Although the fall in unemployment (down from 7.8% in March 2013 to 6.9% in February 2014) to below the Bank's initial threshold was faster than the Bank of England or indeed many analysts had forecast, it hid a stubbornly high level of underemployment. Importantly, average earnings growth remained muted and real wage growth was negative.
- 3.4 In February the Bank stepped back from forward guidance relying on a single indicator – the unemployment rate – to more complex measures which included spare capacity within the economy. The Bank also implied that when official interest rates were raised, the increases would be gradual – this helped underpin the 'low for longer' interest rate outlook despite the momentum in the economy.

4 **The borrowing requirement and debt management**

	Balance on 31/03/2013 £m	Net new borrowing £m	Balance on 31/03/2014 £m
Long Term Borrowing	376.0	-2.8	373.2
Temporary borrowing	41.1	-5.8	35.3
Total Borrowing	417.1	-8.6	408.5
Other Long Term Liabilities	133.8	26.2	160.0
Total External Debt	550.9	17.6	568.5

- 4.1 The Council's underlying need to borrow as measured by the Capital

Financing Requirement (CFR) as at 31/3/2014 was estimated at £771m. The Council's borrowing requirement during the year in the capital programme was £17m, which was funded internally. External borrowing in the form of long-term loans has decreased through a small repayment of external debt, whilst liabilities resulting for Private Finance Initiatives (PFI), shown in the table above under long-term liabilities, has increased as the delivery of the Street Lighting PFI continues.

- 4.2 The indicator for total external debt is obtained directly from the Authority's balance sheet. It is the closing balance for actual gross borrowing plus other long-term liabilities. This Indicator is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit.
- 4.3 A cautious approach has been applied in terms of take-up of new borrowing to minimise debt interest payments without compromising the long-term stability of the portfolio. Internal resources in lieu of external borrowing have been used in order to lower overall treasury risk by reducing both external debt and temporary investments.

5 Investment activity

- 5.1 The County Council has invested according to a low risk, high quality lending list as outlined in the Investment Strategy for 2013/14.

	Balance on 31/03/2013 £m	Balance on 31/03/2014 £m	Average Rate on 31/03/2014	Average Life on 31/03/2014
Instant access monies	62.4	76.0	0.54%	0 yrs
Short term investments	275.0	350.0	0.83%	0.39 yrs
Long term investments	110.0	95.5	1.76%	5.44 yrs
Total investments	447.4	521.5	0.96%	1.26 yrs

- 5.2 Security of capital remained the County Council's main investment objective. This was maintained by following the County Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2013/14. Investments during the year included:
- deposits in AAA-rated Money Market Funds
 - deposits with UK local authorities
 - call accounts and deposits with banks and building societies.
- 5.3 Counterparty credit quality was assessed and monitored with reference

to:

- credit ratings
- credit default swaps
- any potential support mechanisms
- share prices.

5.4 The minimum long-term counterparty credit rating determined for the 2013/14 treasury strategy was A-/A3 across rating agencies Fitch, S&P and Moody's. Based on the factors above and advice from the Treasury Management advisors, Arlingclose, the Director of Corporate Resources has varied investment duration limits for new investments according to the assessment of credit risk and will suspend investing with individual counterparties at any time if this is felt to be necessary to protect the County Council's capital.

5.5 During March 2014 Moody's downgraded NatWest, the County Council's banker, to Baa1, one notch below the minimum criteria of A-/A3. The County Council was prepared for this eventuality with investments already being limited to overnight. As a result of this news the County Council withdrew all of its investments in accordance with the Treasury Management Strategy.

5.6 As outlined in the Strategy the Council's banker is slightly different to all other investment counterparties and although new investments have been suspended, NatWest will continue to hold small amounts of the County Council's cash balances as a result of its banking services. The County Council and its advisors, Arlingclose, are maintaining a careful watch on NatWest and can take further action to protect the County Council's funds if there are additional negative indicators.

5.7 The County Council maintained a sufficient level of liquidity through the use of Money Market Funds and the use of call accounts. The County Council sought to optimise returns commensurate with its objectives of security and liquidity. The UK base rate was maintained at 0.5% through the year and short term money market rates remained at very low levels which had a significant impact on cash investment income. The County Council's average cash investment balance was £597.1m during 2013/14, and interest earned was £5.4m giving a yield of 0.90%.

6 **Compliance with Prudential Indicators**

6.1 The County Council can confirm that it has complied with its Prudential Indicators for 2013/14, which were set in February 2013 as part of the County Council's Treasury Management Strategy Statement. Performance against each of the indicators is shown in Appendix 1.

7 Update on the 2014/15 Investment Strategy

Higher yielding investments

- 7.1 As part of the County Council's 2014/15 Treasury Management strategy approved in February 2014 and effective immediately, a number of changes to the investment strategy were approved to increase both the security of the County Council's investments and increase the yield earned on investments.
- 7.2 It was agreed that £90m of the County Council's cash balances could be set aside for long term investments (of up to 30 years) in order increase the interest earned. These investments will be made with the assistance of the County Council's advisors Arlingclose during 2014/15; initially aiming to target investments with other Local Authorities, but also considering investments in pooled property, equity and bonds, if there are favourable opportunities.
- 7.3 To date opportunities to investment with other Local Authorities have been more limited than expected, possibly due to the most Central Government funding being granted at the beginning of the financial year, making it a time when Local Authorities are less willing to enter into long term borrowing arrangements. Based on Arlingclose's advice the County Council has built up an £8.8m position in long-dated Transport for London bonds yielding an average of 3.74%. In addition the County Council has made a £10m commitment to invest in the CCLA Local Authorities' pooled property fund at the end of May 2014. The County Council with the assistance of Arlingclose is continuing to look for additional opportunities to invest the remainder of the allocated £90m, and further options are currently being considered.

Bond investments

- 7.4 As reported in the 2014/15 Treasury Management Strategy the Financial Services (Banking Reform) Act 2013 and additional EU legislation now prevents Central Government from 'bailing out' banks that get into financial difficulty, as they did in 2008. This increases the risk to capital of institutional investors, such as the County Council, of being 'bailed-in' to support a failing bank, as already seen in Cyprus, to a limited extent with investors in the Co-op Bank and a small number of other examples across Europe.
- 7.5 In response to this risk the 2014/15 Treasury Management Strategy reduced the individual counterparty limit for investments, thereby limiting the Authority's exposure to any single institution. Based on Arlingclose's advice to further diversify the Authority's investments it is recommended it considers investing in high credit quality bonds issued by banks and other private companies, which offer two advantages. By not being limited to banks this will increase the number of counterparties the Authority can invest in, further diversifying the level of overall counterparty risk. In addition bond investments that are

issued by banks are treated differently to cash investments and are not subject to 'bail-in' risk.

- 7.6 It is recommended that bond investments are added to the County Council's investment strategy and the duration of any non-local authority bond investment should be linked to the counterparties credit rating as follows:

Counterparty		Cash limit	Time limit
Banks and other organisations issuing bonds whose lowest published long-term credit rating from Fitch, Moody's and Standard & Poor's is:	AAA	£80m per counterparty (including other types of invest)	10 years
	AA+		5 years
	AA		4 years
	AA-		3 years
	A+		2 years
	A		1 year

- 7.7 Any bond investment of more than 1 year's duration will count as a non-specified investment under the Department of Communities and Local Government's guidance and be limited by the £250m limit on investments greater than one year specified in the County Council's investment strategy.

Appendix 1 – Compliance with Prudential Indicators

The County Council approved the adoption of the CIPFA Treasury Management Code at its meeting on 18 February 2010. In compliance with the requirements of the Code this section of the report provides Members with a summary of actual performance against each of the Prudential Indicators.

1. Capital Financing Requirement (CFR)

Estimates of the Authority's cumulative maximum external borrowing requirement for 2013/14 to 2015/16 are shown in the table below:

	31/03/14 Approved £m	31/03/14 Revised £m	31/03/14 Actual £m	31/03/15 Estimate £m	31/03/16 Estimate £m
Capital Financing Requirement	769	769	771	761	739

2. Gross Debt and the Capital Financing Requirement

In order to ensure that over the medium term debt will only be for a capital purpose, the Authority should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence.

Debt	31/03/14 Approved £m	31/03/14 Revised £m	31/03/14 Actual £m	31/03/15 Estimate £m	31/03/16 Estimate £m
Borrowing	379	369	373	354	343
PFI liabilities	163	163	160	184	176
Total Debt	442	532	533	538	519
Borrowing in excess of CFR?			No	No	No

Total debt is expected to remain below the CFR during the forecast period.

3. Authorised Limit and Operational Boundary for External Debt

The Operational Boundary for External Debt is based on the Authority's estimate of most likely, i.e. prudent, but not worst case scenario for external debt. It links directly to the Authority's estimates of capital expenditure, the capital financing requirement and cash flow requirements and is a key management tool for in-year monitoring. Other long-term liabilities comprise finance lease, Private Finance Initiative and other liabilities that are not borrowing but form part of the Authority's debt.

The Authorised Limit for External Debt is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Authority can legally owe. The authorised

limit provides headroom over and above the operational boundary for unusual cash movements.

There were no breaches to the Authorised Limit and the Operational Boundary during 2013/14; borrowing at its peak was £581m.

	Operational Boundary (Approved) 31/03/2014	Authorised Limit (Approved) 31/03/2014	Actual External Debt 31/03/2014
Borrowing	630	660	409
Other Long-term Liabilities	170	210	160
Total	800	870	569

4. Maturity Structure of Fixed Rate Borrowing

This indicator is to limit large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates.

Maturity Structure of Fixed Rate Borrowing	Lower Limit %	Upper Limit %	Actual Fixed Rate Borrowing at 31/03/2014		Compliance with Set Limits?
			£m	%	
under 12 months	0	50	14.6	4.0	Yes
12 months and within 24 months	0	50	11.5	3.1	Yes
24 months and within 5 years	0	50	33.9	9.2	Yes
5 years and within 10 years	0	75	43.6	11.8	Yes
10 years and within 20 years	0	75	130.0	35.3	Yes
20 years and within 30 years	0	75	119.0	32.3	Yes
30 years and within 40 years	0	100	10.0	2.7	Yes
40 years and above	0	100	6.0	1.6	Yes

5. Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure

This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the amount of net principal borrowed.

	Approved Limits for 2013/14	Maximum during 2013/14	Compliance with Limits:
Upper Limit for Fixed Rate Borrowing	810	458	Yes
Upper Limit for Variable Rate Borrowing	810	123	Yes
Upper Limit for Fixed Rate Investments	600	422	Yes
Upper Limit for Variable Rate Investments	510	339	Yes

6. Capital Expenditure

This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits and, in particular, to consider the impact on Council tax. Capital expenditure has been and will be financed or funded as follows:

Capital Expenditure and Financing	31/03/14 Approved £m	31/03/14 Revised £m	31/03/14 Actual £m	31/03/15 Estimate £m	31/03/16 Estimate £m
Total Expenditure	256	220	212	284	218
Capital receipts	17	14	15	8	14
Government Grants	88	63	88	114	96
Capital reserve	17	8	-23	41	18
Revenue contributions	25	28	28	29	29
Capital contributions (from other bodies)	18	18	18	31	31
Contributions from reserves	4	3	2	19	4
Total Financing	169	134	128	242	192
Supported borrowing	25	30	35	4	0
Prudential borrowing	27	21	17	9	26
Finance lease	35	35	32	29	0
Total Funding	87	86	84	42	26
Total Financing and Funding	256	220	212	284	218

7. Ratio of Financing Costs to Net Revenue Stream

This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

	31/03/14 Approved	31/03/14 Revised	31/03/14 Actual	31/03/15 Estimate	31/03/16 Estimate
Ratio of Financing Costs to Net Revenue Stream	9.56%	7.58%	7.38%	7.53%	7.40%

8. Adoption of the CIPFA Treasury Management Code

This indicator demonstrates that the Authority adopted the principles of best practice.

The Authority adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition* on 18 February 2010.

9. Upper Limit for Total Principal Sums Invested Over 364 Days

The purpose of this limit is to contain exposure to the possibility of loss that may arise as a result of the Authority having to seek early repayment of the sums invested.

	31/03/14 Approved £m	31/03/14 Revised £m	31/03/14 Actual £m	31/03/15 Estimate £m	31/03/16 Estimate £m
Sums Invested Over 364 Days	150	250	96	250	250