

<b>Audit Committee</b>	
<b>Meeting Date</b>	<b>21 September 2015</b>
<b>Report Title</b>	<b>Annual Treasury Management Report 2014/15</b>
<b>Cabinet Member</b>	<b>Cllr Duncan Dewar-Whalley, Cabinet Member for Finance</b>
<b>SMT Lead</b>	<b>Nick Vickers, Head of Finance</b>
<b>Head of Service</b>	<b>Nick Vickers, Head of Finance</b>
<b>Lead Officer</b>	<b>Olga Cole, Management Accountant</b>
<b>Key Decision</b>	<b>No</b>
<b>Classification</b>	<b>Open</b>
<b>Forward Plan</b>	<b>Reference number</b>

<b>Recommendations</b>	1. To approve the Treasury Management stewardship report for 2014/15.
	2. To approve the prudential and treasury management indicators within the report.

## **1. Purpose of Report and Executive Summary**

- 1.1 The Council's treasury management activity is underpinned by the Chartered Institute of Public Finance and Accountancy's (CIPFA's) Code of Practice on Treasury Management ("the Code"), which requires local authorities to produce annually Prudential Indicators and a Treasury Management Strategy Statement on the likely financing and investment activity. The Code also recommends that members are informed of treasury management activities at least twice a year.
- 1.2 Treasury management is defined as "the management of the local Council'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".
- 1.3 Overall responsibility for treasury management remains with the Council. No treasury management activity is without risk; the effective identification and management of risk are integral to the Council's treasury management objectives.
- 1.4 This report:
- is prepared in accordance with the revised CIPFA Treasury Management Code and the revised Prudential Code;
  - details the implications of treasury decisions and transactions;
  - gives details of the outturn position on treasury management transactions in 2014/15; and

- confirms compliance with Treasury limits and Prudential Indicators.

1.5 This report will be submitted to Council on 21 October 2015.

## 2. Background

### Market Environment

- 2.1 There was no change in the UK base rate of 0.5% during the year. Returns from unsecured bank deposits remained low, with some counterparties offering rates no better than the 0.25% available for 'no risk' from the Debt Management Office. Arlingclose, the Council's treasury adviser, are forecasting no increase in the UK base rate until May 2016 – by which time on the general consensus rate rises will have started in the US. In the UK, the Bank of England and many commentators anticipate rates rising to around 2.5% in small increments – so about half the previous long-term norm.
- 2.2 The main economic issue in the year was the reduction in inflation and even in the UK the possibility of deflation. This reflects falls in commodity prices and oil in particular. Whilst the UK has benefitted from consumer led economic growth the global position looks less than favourable outside of the US. Europe appears to be mired in a long recession with anaemic economic growth and the relative decline in China's growth rate poses a significant headwind for UK and European exporters.

### Borrowing Requirement and Debt Management

2.3 The overall borrowing position is summarised below:

	Balance on 31/3/2014 £000's	Debt Maturing £000's	New Borrowing £000's	Balance on 31/3/2015 £000's
Capital Funding Requirement	5,475	0	0	5,106
Short Term Borrowing	0	0	0	0
Long Term Borrowing	0	0	0	0
<b>TOTAL EXTERNAL DEBT</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
Other Long Term Liabilities (cost of leases for equipment)	834	0	0	753
<b>TOTAL EXTERNAL DEBT</b>	<b>834</b>	<b>0</b>	<b>0</b>	<b>753</b>

- 2.4 The Council undertook no borrowing in the year but full Council did agree an in year variation to the Budget Framework to allow borrowing to occur for funding the Sittingbourne multi-storey car park and a possible co-investment in purchasing the Forum Shopping centre in Sittingbourne. Both projects are currently on hold but the permission to borrow is extant.
- 2.5 All borrowing is internally financed.

## Investment Activity

- 2.6 The Council held average cash daily balances of £28m during the year. These represented working cash balances / capital receipts, and the Council's reserves.
- 2.7 The Communities and Local Government's (CLG's) Guidance on Investments, revised during 2009/10, reiterated security and liquidity as the primary objectives of a prudent investment policy. Although the Guidance became operative on 1 April 2010, its principal recommendations run parallel to the credit risk management requirements in the revised Treasury Management Code. In the revised Guidance, Specified Investments are those made with a body or scheme of "high credit quality". Both the Guidance and the revised Treasury Management Code emphasise that counterparty credit criteria should not rely on credit ratings alone but should include a wider range of indicators. The revised Code nonetheless requires that ratings assigned by all three rating agencies – Fitch, Moody's and Standard & Poor's – be taken into account and the lowest rating be used.
- 2.8 The criteria applied by the Head of Finance for the approval of a counterparty are:
- Credit rating - a minimum long-term of A-
  - Credit default swaps.
  - Share price.
  - Reputational issues.
  - Exposure to other parts of the same banking group.
  - Country exposure.
- 2.9 The investments permissible in 2014/15 were:

<b>Investment Instruments – (in sterling)</b>	<b>Limits and Maturity dates</b>
Government backed deposits <ul style="list-style-type: none"> <li>• The UK government</li> <li>• Gilt Edged Securities</li> </ul>	<ul style="list-style-type: none"> <li>• Unlimited amount and maturity up to 364 days</li> <li>• Unlimited amount and maturity up to 364 days</li> </ul>
Banking deposits <ul style="list-style-type: none"> <li>• Money Market Funds and Collective Investment Schemes</li> <li>• UK Banks and Building Societies</li> </ul>	<p>£1.5m limit for AAA rated funds as defined by Fitch, Moody's and Standard and Poor's (funds are held on call).</p> <p>£3m limit per counterparty for minimum A-rated institutions as defined by Fitch, and/or equivalent ratings by Moody's and Standard &amp; Poor's. Maximum period 364 days.</p>
Svenska Handelsbanken	£3m limit
Close Brothers	£1m limit
Leeds Building Society	£1m limit
Small UK Building Societies	£250k each or max £1m in aggregate
Supranational Bonds	£6m in aggregate
Certificate of Deposits	£3m limit per counterparty

2.10 The UK financial institutions used in 2014/15 were:

- Lloyds Bank Plc
- Barclays Bank Plc
- HSBC Bank Plc
- Santander UK Plc
- Nationwide Building Society
- Svenska Handelsbanken
- Close Brothers
- CCLA Property Fund (introduced in line with the 2015/16 Treasury Strategy agreed in February)
- Standard Chartered
- Leeds Building Society
- Money Market Funds
- The Council also makes use of the Debt Management Account Deposit Facility Account with the Debt Management Office.

2.11 The Royal Bank of Scotland and National Westminster Bank were suspended for use in March 2014 as they ceased to meet our minimum credit requirement and have not been used since.

2.12 The financial reserves of the Council are crucial in funding small one-off initiatives where there is no flexibility in a restricted revenue budget and in helping the Council meet corporate priorities, in particular regeneration across the borough. This puts an even greater emphasis on a low risk investment strategy where protection of the principal sum is the prime objective. The Council has therefore almost exclusively used highly rated and liquid Money Market Funds and unsecured bank deposits with major financial institutions – exclusively UK institutions with the exception of Svenska Handelsbanken a highly rated Swedish bank with a UK branch network.

2.13 As reported in the February Treasury Strategy the Council needs to be alert to the changes in banking legislation being introduced in 2015. The principle of bail-in is that holders of bank equity and debt, and even depositors have to fund any major losses rather than the banks being bailed out by the Government – as RBS and Lloyds were in 2008. The legislation also gives other depositors preference over local authority deposits. This makes it all the more important that we maintain a well-diversified strategy.

2.14 The deposits for the year are summarised below:

<b>Investments</b>	<b>Balance on 31/3/14 £'000</b>	<b>Investments Made £'000</b>	<b>Maturities £'000</b>	<b>Balance on 31/03/15 £'000</b>	<b>Average Rate %</b>	<b>Average Life (days)</b>
Short Term Investments	18,490	171,066	167,256	22,300	0.48	60
Long Term Investments	3	1,500	1	1,502	3.15	Undated
<b>TOTAL INVESTMENTS</b>	<b>18,493</b>	<b>172,566</b>	<b>167,257</b>	<b>23,802</b>		
Increase/ (Decrease) in Investments				5,309		

- 2.15 **Liquidity:** In keeping with the CLG's Guidance on Investments, the Council maintained a sufficient level of liquidity through the use of Money Market Funds, overnight deposits and the use of call accounts.
- 2.16 **Yield:** The Council sought to optimise returns commensurate with its objectives of security and liquidity. The UK Bank Rate was maintained at 0.5% through the year. Short-term money market rates remained at very low levels.
- 2.17 The Council's budgeted investment income for 2014/15 was £75,000 and the actual income received was £127,000. The extra return reflects higher cash balances throughout the year.

### **Compliance with Prudential Indicators**

- 2.18 The Council has complied with its Prudential Indicators for 2014/15 which were set as part of the Treasury Management Strategy agreed by Council on 19 February 2014.
- 2.19 In Appendix I the outturn position for the year against each Prudential Indicator is set out.

### **Treasury Advisers**

- 2.20 Arlingclose has been the Council's treasury advisers since May 2009. Following a tendering process Arlingclose were reappointed earlier this year. Officers of the Council meet with them regularly and high quality and timely information is received from them.

## **3. Proposal**

- 3.1 Members are asked to approve the report.

## **4. Alternative Proposals**

- 4.1 No alternative proposals have been considered and compliance with the CIPFA Code is mandatory.

## **5. Consultation Undertaken**

- 5.1 Arlingclose have been consulted.

## **6. Implications**

<b>Issue</b>	<b>Implications</b>
Corporate Plan	Supports delivery of the Council's objectives.
Financial, Resource and Property	The Council's Treasury Strategy is agreed annually as part of the budget process.

<b>Issue</b>	<b>Implications</b>
Legal and Statutory	Need to comply with CLG guidance on treasury management.
Crime and Disorder	Not relevant to this report
Risk Management and Health and Safety	Not relevant to this report
Equality and Diversity	Not relevant to this report
Sustainability	Not relevant to this report

## **7. Appendices**

7.1 Appendix I: Treasury Management and Prudential Indicators

## **8. Background Papers**

8.1 Treasury Strategy report, Council 18 February 2015

8.2 Treasury Strategy report, Council 19 February 2014

## Treasury Management and Prudential Indicators for 2014/15

### 1. Background

There is a requirement under the Local Government Act 2003 for local authorities to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the "CIPFA Prudential Code") when setting and reviewing their Prudential Indicators.

### 2. Gross Debt and the Capital Financing Requirement (CFR)

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

The Head of Finance reports that the authority had no difficulty meeting this requirement in 2014/15, nor is there any difficulties envisaged for future years. This view takes into account current commitments, existing plans and the proposals in the approved budget.

<b>Gross Debt and the Capital Financing Requirement</b>	<b>2014/15 Actual £'000</b>	<b>2015/16 Estimate £'000</b>	<b>2016/17 Estimate £'000</b>
Gross CFR	5,106	5,145	4,833
<b>Less: Other Long Term Liabilities</b>	<b>(753)</b>	<b>(774)</b>	<b>(623)</b>
<b>Borrowing CFR</b>	<b>4,353</b>	<b>4,371</b>	<b>4,210</b>
<b>Less: Existing Profile of Borrowing</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Cumulative Maximum External Borrowing Requirement.</b>	<b>4,353</b>	<b>4,371</b>	<b>4,210</b>

### 3. 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.

<b>Capital Expenditure</b>	<b>2014/15 Actual £'000</b>	<b>2015/16 Estimate £'000</b>	<b>2016/17 Estimate £'000</b>
<b>Total</b>	<b>2,219</b>	<b>1,103</b>	<b>15</b>

Capital expenditure will be financed as follows:

<b>Capital Financing</b>	<b>2014/15 Actual £'000</b>	<b>2015/16 Estimate £'000</b>	<b>2016/17 Estimate £'000</b>
Capital receipts	528	30	0
Government Grants	1,270	1,058	0
Revenue contributions	421	15	15
<b>Total Financing</b>	<b>2,219</b>	<b>1,103</b>	<b>15</b>

## Treasury Management and Prudential Indicators for 2014/15

### 4. Ratio of Financing Costs to Net Revenue Stream

This is an indicator of affordability, highlighting the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs. The definition of financing costs is set out in the Prudential Code.

The ratio is based on costs net of investment income.

<b>Ratio of Financing Costs to Net Revenue Stream</b>	<b>2014/15 Actual %</b>	<b>2015/16 Estimate %</b>	<b>2016/17 Estimate %</b>
<b>Total</b>	<b>1.58</b>	<b>1.70</b>	<b>1.71</b>

### 5. Incremental Impact of Capital Investment Decision

This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax levels. The incremental impact on Council Tax is the difference between the total revenue budget requirement of the current approved capital programme and the revenue budget requirement from the capital programme proposed.

<b>Incremental Impact of Capital Investment Decisions</b>	<b>2014/15 Actual £</b>	<b>2015/16 Estimate £</b>	<b>2016/17 Estimate £</b>
Decrease in Band D Council tax	(0.01)	(0.01)	0.00

### 6. Capital Financing Requirement

The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. The calculation of the CFR is taken from the amounts held in the Balance Sheet relating to capital expenditure and its financing.

<b>Capital Financing Requirement</b>	<b>2014/15 Actual £'000</b>	<b>2015/16 Estimate £'000</b>	<b>2016/17 Estimate £'000</b>
<b>Total CFR</b>	<b>5,106</b>	<b>5,145</b>	<b>4,833</b>



## Treasury Management and Prudential Indicators for 2014/15

### 7. Actual External Debt

This indicator is obtained directly from the Council'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. The long-term liabilities relate to finance lease arrangements for the provision leisure management equipment and embedded leases representing the value of equipment for the exclusive use for the Council by its grounds maintenance contractors.

<b>Actual External Debt as at 31/03/2015</b>	<b>£'000</b>
Borrowing	0
Other Long-term Liabilities	753
<b>Total</b>	<b>753</b>

### 8. Authorised Limit and Operational Boundary for External Debt

The Authorised Limit sets the maximum level of external borrowing on a gross basis (i.e., not net of investments) for the Council. It is measured on a daily basis against all external borrowing items on the Balance Sheet (i.e., long and short-term borrowing, overdrawn bank balances and long-term liabilities). This Prudential Indicator separately identifies borrowing from other long-term liabilities such as finance leases. It is consistent with the Council's existing commitments, its proposals for capital expenditure and financing, and its approved treasury management policy statement and practices.

The Authorised Limit has been set on the estimate of the most likely, prudent but not worst case scenario with sufficient headroom over and above this to allow for unusual cash movements.

The Authorised Limit is the statutory limit determined under Section 3(1) of the Local Government Act 2003 (referred to in the legislation as the Affordable Limit).

<b>Authorised Limit for External Debt</b>	<b>2014/15 Estimate £'000</b>	<b>2015/16 Estimate £'000</b>	<b>2016/17 Estimate £'000</b>
Borrowing	5,000	7,000	7,000
Other Long-term Liabilities	2,000	2,000	2,000
<b>Total</b>	<b>7,000</b>	<b>9,000</b>	<b>9,000</b>

## Treasury Management and Prudential Indicators for 2014/15

The Operational Boundary links directly to the Council's estimates of the CFR and estimates of other cash flow requirements. This indicator is based on the same estimates as the Authorised Limit reflecting the most likely, prudent but not worst case scenario but without the additional headroom included within the Authorised Limit.

<b>Operational Boundary for External Debt</b>	<b>2014/15 Estimate £'000</b>	<b>2015/16 Estimate £'000</b>	<b>2016/17 Estimate £'000</b>
Borrowing	2,000	6,000	6,000
Other Long-term Liabilities	992	774	623
<b>Total</b>	<b>2,992</b>	<b>6,774</b>	<b>6,623</b>

The Head of Finance confirms that there were no breaches to the Authorised Limit and the Operational Boundary during 2014/15.

### 9. Adoption of the CIPFA Treasury Management Code

This indicator demonstrates that the Council has adopted the principles of best practise.

The Council adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition* on 22 February 2012.

### 10. Interest Rate Exposures:

This indicator is set to control the Council's exposure to interest rate risk. The Council calculates these limits on net principal outstanding sums (i.e., fixed rate debt net of fixed rate investments).

<b>Upper Limit</b>	<b>2014/15 Estimate</b>	<b>2014/15 Actual %</b>	<b>2015/16 Estimate %</b>	<b>2016/17 Estimate %</b>
Interest on fixed rate borrowing	100	0	100	100
Interest on fixed rate investments	-100	-55	-100	-100
<b>Upper Limit for Fixed Interest Rate Exposure</b>	<b>0</b>	<b>-55</b>	<b>0</b>	<b>0</b>
Interest on variable rate borrowing	100	0	100	100
Interest on variable rate investments	-100	-45	-100	-100
<b>Upper Limit for Variable Interest Rate Exposure</b>	<b>0</b>	<b>-45</b>	<b>0</b>	<b>0</b>

As the Council has no borrowing, these calculations have resulted in a negative figure.

## Treasury Management and Prudential Indicators for 2014/15

### 11. Maturity Structure of Borrowing

This indicator highlights the existence of any large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates. It is designed to protect against excessive exposures to interest rate changes in any one period, in particular in the course of the next ten years.

<b>Maturity Structure of Borrowing</b>	<b>Existing level at 31/03/15 %</b>	<b>Lower Limit for 2015/16 %</b>	<b>Upper Limit for 2015/16 %</b>
Under 12 months	0	0	100
12 months and within 24 months	0	0	100
24 months and within 5 years	0	0	100
5 years and within 10 years	0	0	100
10 years and above	0	0	100

The Council does not have any external borrowing for capital purposes, and did not need to borrow for cash flow purposes during 2014/15.

### 12. Credit Risk

The Council considers security, liquidity and yield, in that order, when making investment decisions.

Credit ratings remain an important element of assessing credit risk, but they are not a sole feature in the Council's assessment of counterparty credit risk.

The Council also considers alternative assessments of credit strength, and information on corporate developments of and market sentiment towards counterparties. The following key tools are used to assess credit risk:

- published credit ratings of the financial institution (minimum A- or equivalent and its sovereign (minimum AA+ or equivalent for non-UK sovereigns):
- sovereign support mechanisms;
- credit default swaps (where quoted);
- share prices (where available);
- economic fundamentals, such as a country's net debt as a percentage of its GDP;
- corporate developments, news, articles, markets sentiment and momentum; and
- subjective overlay.

The only indicators with prescriptive values remain to be credit ratings. Other indicators of creditworthiness are considered in relative rather than absolute terms.

The Head of Finance confirms that there were no breaches to counterparty limits or credit ratings at the time of placing investments.

## Treasury Management and Prudential Indicators for 2014/15

**13. Upper Limit for Total Principal Sums Invested for Periods Longer than 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.

<b>Total Principal Sums Invested Over 364 Days</b>	<b>2014/15 £'000</b>	<b>2015/16 £'000</b>	<b>2016/17 £'000</b>
Upper Limit Estimate	7,000	9,000	9,000
Actual	1,500	-	-

**14. Investment Benchmarking**

<b>Average Actual Return on investments 2014/15</b>	<b>Original Estimate Return on Investments 2014/15</b>	<b>Average Bank Rate 2014/15</b>	<b>Average 7 day LIBID Rate 2014/15</b>
0.45%	0.28%	0.50%	0.35%