AGENDA ITEM 8	**WEST DEVON BOROUGH COUNCIL**	AGENDA ITEM 8

NAME OF COMMITTEE	**Audit Committee**
DATE	**23 September 2014**
REPORT TITLE	**Treasury Management – Annual Report 2013/2014**
Report of	**Head of Finance & Audit**
WARDS AFFECTED	**All**

Summary of report:
The Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury report reviewing treasury management activities and the actual prudential and treasury indicators for 2013/14.

Financial implications:
There are no financial implications that directly relate to this report but there is budgeted investment income of £45,321, and the actual outturn for the financial year is £27,929.55. The report shows that the Council exceeded the benchmark of 0.39% on its investment activity, by achieving a 0.42% return on its investments up to 31 March 2014

RECOMMENDATIONS:
It is recommended that Members:

1. review and scrutinise the Treasury Management Report for 2013/2014 and recommend to Council that the contents of the report are noted;

2. note the actual 2013/2014 prudential indicators within this report, shown in Appendix A; and,

3. Members note the Minimum Revenue Provision Statement, as detailed in 6.2 of the report for 2013/14.

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1. BACKGROUND

1.1 The Council adopted the CIPFA Code of Practice for Treasury Management in the Public Sector and operates its treasury Management service in compliance with this code. The prime objective of the treasury management activity is the effective management of risk.

1.2 This report summarises:

- Capital activity during the year
- Impact of this activity on the Council underlying indebtedness (the Capital Financing Requirement)
- Reporting of the required prudential indicators and treasury indicators
- Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on the investment balances
- Summary of interest rate movements in the year
- Detailed debt activity
- Detailed investment activity

2. ISSUES FOR CONSIDERATION

2.1 The Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury report reviewing treasury management activities and the actual prudential and treasury indicators for 2013/14. This report meets the requirements for 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).

2.2 During 2013/14 the minimum reporting requirements were that the Council should receive the following reports:

- an annual treasury strategy in advance of the year (Audit Committee)
- a mid year treasury update report (Audit Committee 10/12/13)
- an annual report following the year describing the activity compared to the strategy (this report)

In addition, the Audit Committee has received quarterly treasury management reports.

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

2.4 This Council also 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 Audit Committee before they were reported to full Council. Member training on treasury management issues was undertaken in January 2012 in order to support Members' scrutiny role.

3. THE 2013/2014 STRATEGY

3.1 The expectation for interest rates within the strategy for 2013/14 anticipated low but rising Bank rate (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.

3.2 During 2013/14, the Council complied with its legislative and regulatory requirements. The key actual indicators detailing the impact of capital expenditure activities during the year, with comparators, are shown in Appendix A.

3.3 The financial year 2013/14 continued the challenging environment of previous years, low investment returns and continuing counterparty risk continued.

4. BENCHMARK AND PERFORMANCE INDICATORS FOR 2013/14

4.1 One of the key requirements in the code is the formal introduction of performance measurement 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 Strategy.

4.2 The table attached in Appendix B details the benchmarking exercise for all money market investments managed internally and externally against a 3-month LIBID benchmark. All the investments have been weighted appropriately to reflect the fact that their duration did not cover the whole of the financial year. The Council exceeded the benchmark of 0.39% on its investment activity, by achieving a return of 0.42% on its investments for the 2013/2014 financial year.

4.3 Investments held by the Council – a percentage of the investment funds managed internally by the Council are kept short to manage the capital expenditure; this has an effect on the rates that are able to be achieved. Therefore performance tends to be more stable but slightly lower over the longer term than externally managed funds.

5. INVESTMENTS PLACED 1 APRIL 2013 TO 31 MARCH 2014 AND INTEREST ACHIEVED

5.1 The total interest received in the 2013/2014 financial year, including accruals of interest and less the necessary deductions was 27,929.55, as detailed in the table below:

	Interest Received in the year	
Fixed Term Investments	£	15,852.75
Natwest Special Interest Bearing Account	£	4,237.19
Deutsche – Money Market Fund	£	1,882.32
Ignis – Money Market Fund	£	5,611.40
Interest on Loans	£	281.79
Interest on war stock	£	64.10
Total Interest Received 2013/14	**£**	**27,929.55**

5.2 The Council's budgeted investment income for 2013/14 was £45,321, but the actual income received was £27,929.55 due to the Base Rate remaining at 0.5%. The Council has also been restricted in the availability of counterparties to be able to invest with, due to many banks and building societies having reduced credit ratings following the banking crisis.

5.3 The interest that the deposits attracted can be divided into four groups:

(i) Fixed Term Deposits – consisting of all deposits with the exception of those placed on the Councils Business Reserve account at the Natwest Bank and Money Market Funds (see (ii) and (iii) below). The interest received will depend upon the rate applicable at the time of placement. During the period the rates attained have been as follows:

Type of Deposit	**Rates attained**		**Average**
	Highest	**Lowest**	
Fixed Term (UK Banks, Foreign Banks & Building Societies)	0.50%	0.39%	0.41%

Quoted rates for comparison	**Highest**	**Lowest**	**Average**
Base Rate	0.50%	0.50%	0.50%
3-month LIBID	0.40%	0.37%	0.39%

(ii) Natwest Special Interest Bearing Account – The balance on the account during the 2013/2014 financial year varies on a daily basis up to a maximum of £2,000,000, with the balance at the close of business on 31st March 2014 standing at £1,630,072.31. The account pays interest on a quarterly basis and has earned £4,237.19 during the 2013/2014 financial year.

(iii) Deutsche Money Market Fund – The balance held in the fund during the 2013/2014 financial year has varied between Nil and £2,000,000, with the balance at the close of business on 31st March 2014 standing at Nil. The fund pays interest on a monthly basis and has earned £1,882.32 during the 2013/2014 financial year.

Ignis Money Market Fund – The balance held in the fund during the 2013/14 financial year has varied between Nil and £2,000,000, with the balance at the close of business on 31st March 2014 standing at Nil. The fund pays interest on a monthly basis and has earned £5,611.40 during the 2013/14 financial year.

6. THE COUNCIL'S TREASURY POSITION AT THE YEAR END

6.1 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 investment 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 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:

Treasury Position	31 March 2013	31 March 2014
Fixed Interest Rate Debt	£2,100,000	*£2,100,000
Variable Interest Rate Debt	Nil	Nil
Total Debt	**£2,100,000**	**£2,100,000**
Fixed Interest Investments	£1,000,000	£2,000,000
Variable Interest Investments (Money Market Fund)	Nil	Nil
Total Investments	**£1,000,000**	**£2,000,000**
Net Position	**£-1,100,000**	**£-100,000**

* During the year for 2013/2014 the amount of interest charged was £95,550 based on the interest rate of 4.55%.

6.2 The Council is required to pay off an element of the borrowing each year through a revenue charge (the **Minimum Revenue Provision**, MRP). The Council is recommended to approve the following MRP Statement.

For capital expenditure the MRP policy will be based on the Capital Finance Requirement (CFR) (option 2 of the regulations).

For all unsupported borrowing the MRP policy will be **Asset Life Method** – the MRP will be based on the estimated life of the assets, in accordance with the proposed regulations (option 3 of the regulations).

This means that effectively the method used for calculating a provision to repay the borrowing is on the same basis as the life of the asset i.e. 50 years.

6.3 External borrowing under the Prudential Code was undertaken during 2007/2008 principally to finance the costs of the Council's Capital programme. The Council borrowed £2.1 million from the Public Works Loan Board (PWLB) on 2nd August 2007 at a fixed rate of 4.55% for 45 years and 6 months. Any costs of borrowing are borne in the Statement of Movement on the General Fund Balance by interest charges and the Minimum Revenue Provision for the repayment of debt. The Minimum Revenue Provision has been applied in 2013/14 and has been calculated at £42,000 per year. This is the borrowing of £2.1 million, divided by the life of the asset of 50 years, which equates to £42,000 per annum.

7. CAPITAL FINANCING DECISION TAKEN DURING 2013/14

7.1 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.

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

	2012/13 Actual	2013/14 Actual
Total capital expenditure	**1,875,000**	**490,084**
Financed by:		
Capital Receipts	1,025,000	311,367
Capital grants & contribution	745,000	178,717
Capital Reserves	Nil	Nil
Revenue	63,000	Nil
Earmarked Reserves	Nil	Nil
Net financing need for the year	**42**	**Nil**

8. THE COUNCIL'S OVERALL BORROWING NEED

8.1 The Council's underlying need to borrow for capital expenditure is called the Capital Financing Requirement (CFR). This figure is a gauge of the Council's debt position. The CFR results from the capital activity of the Council and what resources have been used to pay for the capital spend. It represents the 2013/14 unfinanced capital expenditure (see previous table), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

8.2 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.

8.3 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 the non-housing Revenue Account borrowing need. This differs from the Treasury Management arrangements to 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.

8.4 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).

The Council's 2013/14 MRP Policy (as required by CLG Guidance) was approved as part of the Treasury Management Annual Report for 2012/13 on 23/07/2013.

The Council's CFR for the year is shown below, and represents a key prudential indicator.

CFR (£m)	31 March 2013 Actual	31 March 2014 Actual
Opening Balances	£1,842,000	£1,842,000

The borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit. The Minimum Revenue Provision has been applied in 2013/14 and has been calculated at £42,000 per year. This is the borrowing of £2.1 million, divided by the life of the asset of 50 years, which equates to £42,000 per annum.

8.6 Net borrowing and the CFR – in order to ensure that borrowing levels are prudent over the medium term the Council's external borrowing, net of investments must only be for a capital purpose. This essentially means that the Council is not borrowing to support revenue expenditure. Net borrowing should not therefore, except in the short term, have exceeded the CFR for 2013/14 plus the expected changes to the CFR over 2014/15 and 2015/16. 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 net borrowing position against CFR. The Council has complied with this prudential indicator.

	31 March 2013 Actual	31 March 2014 Actual
Net borrowing position	£2,100,000	£2,100,000
CFR	£1,842,000	£1,842,000

8.7 The authorised limit – the authorised limit is the “affordable borrowing limit” required by s3 of the Local Government Act 2003. The Council does not have the power to borrow above this level. The table in 8.9 demonstrates that during 2013/14 the Council maintained gross borrowing within its authorised limit.

8.8 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 above the boundary is acceptable subject to the authorised limit not being breached.

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

	2013/14
Authorised limit	£6.0m
Maximum gross borrowing position	£2.1m
Operational boundary	£3.0m
Average gross borrowing position	£2.1m
Financing costs as a proportion of net revenue stream	(1.65%)

9. ECONOMIC TRENDS FOR 2013/14

9.1 The original expectation for 2013/14 was that Bank Rate would start gently rising from quarter 1 2015. This forecast rise has 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 additional quantitative easing during 2013/14 and Bank Rate ended the year unchanged at 0.5% for the fifth successive year.

9.2 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.

9.3 Bank rate was unchanged at 0.5% throughout the year while expectations of when the first increase would occur were steadily pushed back until the first half of 2015.

9.4 The Funding for Lending Scheme, announced in July 2012, resulted in a flood of cheap credit being made available to banks and this has resulted in money market investment rates falling sharply in the second half of that year and continuing into 2013/14. The 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.

10. LEGAL IMPLICATIONS

10.1 The Council's treasury management activities are regulated by a variety of professional codes and statutes and guidance:

- The Local Government Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;
- The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions were made in 2012/13);
- Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act;
- The SI requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities;
- The SI also requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services;
- Under the Act the ODPM (now DCLG) has issued Investment Guidance to structure and regulate the Council's investment activities.
- Under section 238(2) of the Local Government and Public Involvement in Health Act 2007 the Secretary of State has taken powers to issue guidance on accounting practices. Guidance on Minimum Revenue Provision was issued under this section on 8th November 2007.

10.2 The Council has complied with all of the above relevant statutory and regulatory requirements which require the Council to identify and, where possible, quantify the levels of risk associated with its treasury management activities. In particular its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach.

10.3 It is a statutory duty for the Council to report its annual position on Treasury Management to the Council as set out in the Constitution by the 30th September each year.

11. FINANCIAL IMPLICATIONS

11.1 Effective Treasury Management strives to maximise investment returns whilst minimising risk and protecting capital. Shorter-term rates and likely future movements in these rates predominately determine the Council's investment return. These returns can therefore be volatile and, whilst the risk of loss of principal is minimised through the annual investment strategy, accurately forecasting future returns can be difficult.

12. RISK MANAGEMENT

12.1 The Council is aware of the risks of passive management of the treasury portfolio and, with the support of Sector, the Council's advisers, has proactively managed its treasury position. The Council uses Sector's Creditworthiness approach when deciding who to invest with in order to mitigate any investment risk. The risk management implications are:

Opportunities	Benefits
For the Council to comply with all of the above relevant statutory and regulatory requirements which limit the levels of risk associated with its treasury management activities.	The Councils adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach.
Issues/Obstacles/Threats	**Control measures/mitigation**
The Council is aware of the risks of passive management of the treasury portfolio and, with the support of Sector, the Council's advisers, has proactively managed its treasury position. Shorter-term rates and likely future movements in these rates predominantly determine the Council's investment return. These returns can therefore be volatile and, whilst the risk of loss of principal is minimised through the annual investment strategy, accurately forecasting future returns can be difficult.	The Council has utilised low borrowing costs and has complied with its internal and external procedural requirements. There is little risk of volatility of costs in the current debt portfolio as the interest rates are predominantly fixed, utilising long-term loans.

7. OTHER CONSIDERATIONS

Corporate priorities engaged:	The report meets all of the corporate priorities
Statutory powers:	See legal implications above
Considerations of equality and human rights:	N/A
Biodiversity considerations:	N/A
Sustainability considerations:	N/A

Crime and disorder implications:	N/A
Background papers:	Treasury Management Strategy and Annual Investment Strategy for 2013/14 to 2015/16 Capital Programme 2013/14 and Prudential Indicators 2013/2014
Appendices attached:	Appendix A – Prudential and Treasury Indicators as at 31st March 2014. Appendix B – Benchmarking 2013/14

STRATEGIC RISKS TEMPLATE

No	Risk Title	Risk/Opportunity Description	Inherent risk status				Mitigating & Management actions	Ownership
			Impact of negative outcome	**Chance of negative outcome**	**Risk score and direction of travel**			
	Opportunity	For the Council to comply with all of the above relevant statutory and regulatory requirements which limit the levels of risk associated with its treasury management activities.	1	1	1	⇔	The Councils adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach.	Head of Finance and Audit
	Risk	The Council is aware of the risks of passive management of the treasury portfolio and, with the support of Sector, the Council's advisers, has proactively managed its treasury position. Shorter-term rates and likely future movements in these rates predominantly determine the Council's investment return. These returns can therefore be volatile and, whilst the risk of loss of principal is minimised through the annual investment strategy, accurately forecasting future returns can be difficult.	3	1	3	⇔	The Council has utilised low borrowing costs and has complied with its internal and external procedural requirements. There is little risk of volatility of costs in the current debt portfolio as the interest rates are predominantly fixed, utilising long-term loans.	Head of Finance and Audit