REPORT TO	DATE OF MEETING
Governance Committee	25 June 2014

Report template revised July 2012

SOUTH RIBBLE BOROUGH COUNCIL forward with South Ribble

SUBJECT	PORTFOLIO	AUTHOR	ITEM
Treasury Management Annual Report 2013/14	Finance & Resources	M L Jackson	6

SUMMARY AND LINK TO CORPORATE PRIORITIES

The current regulatory environment concerning treasury management places a greater onus on members to scrutinise treasury policy and activity. To enable that, each year the Council is required to consider, as a minimum, three treasury reports. These consist of an annual strategy statement in advance of the year (Council 6/3/2013), a mid-year review of that strategy (Governance Committee 27/11/2013), and finally this out-turn report.

The key messages within this report are that Prudential and Treasury Indicators were complied with and that the return on investments totalled 0.83% which exceeded the benchmark of 0.34%. It also provides updated information regarding the Icelandic investments.

RECOMMENDATIONS

Governance Committee is asked to note the report.

DETAILS AND REASONING

The Treasury Strategy for 2013/14 to 2015/16 was submitted to Governance Committee on 30 January 2013 and Cabinet on 6 February 2013. The overall strategy included Prudential Indicators, the Treasury Management Strategy, the Annual Investment Strategy, and the Annual Minimum Revenue Provision (MRP) Policy Statement, all of which were approved by Council on 6 March 2013.

Revised Prudential and Treasury Indicators for 2013/14 were included in the Treasury Strategy 2014/15 to 2016/17, which was approved by Council on 5 March 2014. Where relevant, comparisons with 2013/14 indicators in this report are to those approved most recently.

Prudential Indicator: Capital Expenditure and Financing 2013/14

A comprehensive report on the Capital Programme provisional outturn for 2013/14 has been submitted separately to Governance Committee on this agenda. Total capital expenditure in the year was £1.732m, and expenditure by category and the proposed source of financing is presented in the Capital Financing Requirement table.

Prudential Indicator The Capital Financing Requirement (CFR)

The Capital Financing Requirement (CFR) is a measure of the capital expenditure incurred by the Council which is still to be paid for. Such expenditure will currently be met by borrowing or by temporary use of internal cash balances. Ultimately, however, it has to be paid for and will be a charge to Council Tax payers. The Minimum Revenue Provision (MRP) charged to the Council's revenue budget each year is based on the CFR. Its impact on reducing the CFR is shown in the following table:-

Capital Expenditure and Financing	2013/14 £'000
Opening Capital Financing Requirement	6,284
Capital investment	
Property, Plant and Equipment	1,135
Intangible Assets	143
Revenue Expenditure Funded from Capital under Statute	454
Sources of finance	
Capital Receipts	(56)
Government Grants and Other Contributions	(520)
Sums set aside from revenue	
Revenue Financing (including use of earmarked reserves)	(902)
Minimum Revenue Provision – statutory	(601)
Minimum Revenue Provision – voluntary	(246)
Closing Capital Financing Requirement	**5,691**
Explanation of movements in year	
Increase in prudential borrowing	254
Provision made for debt repayment	(847)
Increase/(Decrease) in Capital Financing Requirement	**(593)**

The estimated CFR as at 31 March was £6.228m, so the outturn figure was £0.537m lower. The reasons for the reduction were that the opening CFR was £0.351m less than estimated; financing by prudential borrowing was £0.196m less; and statutory MRP was £0.010m less than the estimate.

Prudential Indicator: The CFR and Borrowing

In order to ensure that local authorities only borrow for capital purposes the Prudential Code requires that borrowing, net of investments, should not exceed the CFR for the preceding year plus any anticipated increase in the current and next two years. As at 31 March 2014 net borrowing is a negative figure (see Treasury Position as at 31 March 2014 below) and is thus well below the CFR.

Compliance with Borrowing Limits

The Prudential Indicators include two borrowing limits:

• The **Operational Boundary** - This is the probable, expected limit on external debt. "Debt" consists of both borrowings and other long term liabilities (finance leases, and deferred purchase liabilities incurred under the Leisure Partnership). This was set at £1.224m and the limit has not been exceeded. As at 31/3/14 the Council has no long-term external borrowing, and leasing liabilities stand at £1.13m

• The **Authorised Limit** - This reflects a level of debt which the code defines as, "while not desired, could be afforded but may not be sustainable". The limit was set at £3.224m to accommodate any planned temporary borrowings. These were not necessary and the limit set has not been breached.

Prudential Indicator: Ratio of Financing Costs to the Revenue Stream

This indicator shows what percentage of the Council's income from Government grants and Council Tax has been used to meet interest costs and debt repayment. The indicator as per the 2013/14 Treasury Strategy forecast was 6.45%. This has fallen to an outturn of 3.92% as a result

of the increased investment income (mainly Icelandic investments), which reduced financing costs; and increased grant and business rates income, which increased the revenue stream.

Prudential Indicator: Incremental impact of capital investment decisions

This indicator is concerned with capital expenditure over a period of years, and reports its cumulative impact on the revenue account. It is not possible to make meaningful comparison against this indicator, other than when it is restated each year when the Treasury Strategy is produced.

Treasury Position as at 31 March 2014

	As last reported (Treasury Strategy 2014/15) **£000**	**Actual value as at 31 March 2014** **£000**
Total borrowings at period end	**0**	**0**
Cash & investments	**(10,000)**	**(15,335)**
Net Borrowing/(Investments)	**(10,000)**	**(15,335)**

The following table summarises investments activity and returns during the year:-

Details	**Average daily Investment £'000**	**Interest Earned £**	**Average Rate %**
Short Term deposits	5,468	79,747	1.46
Call accounts/Money Market Funds	10,952	57,305	0.52
Bank/Notice Accounts	991	7,282	0.78
Debt Management Office (DMO)	16	41	0.25
Total	**17,427**	**144,375**	**0.83**

The performance benchmark is the 7-day London Inter-Bank Bid Rate (LIBID). This averaged 0.34% over the year, therefore the benchmark has been exceeded. To achieve a return rate 10% greater than LIBID is a key performance indicator for Shared Financial Services.

The average rate achieved in 2012/13 was 1.17% compared to the LIBID of 0.39%. The likelihood is that the average rate earned during 2014/15 will remain low. As cash balances available for investment remain high, it may prove necessary to increase the use of accounts that pay as little as 0.25% interest such as those offered by the DMO, County Council and RBS.

All investments complied with the Council's policy.

The interest total of £0.144m in 2013/14 does not include the interest/impairment reduction arising from the auction of the Council's Landsbanki investment and the Heritable repayment.

Treasury Indicator: Upper limit on exposure to variable interest rates

The authority is exposed to variable interest rates on all its invested cash. There is no real limit on such investments other than the size of the Council's cash balances. The Treasury Strategy anticipated these would peak at £25m. This was not exceeded during the year, the peak being £23m.

Icelandic Investments

At the start of 2013/14, the impaired balance sheet value of the Council's investment in Landsbanki was £1.322m. During the year, the Winding-Up Board made one repayment of £0.169m, which reduced the balance sheet value of the investment to £1.153m.

Recovery of the remainder of the investment was expected to take several years, and would involve exchange rate losses on repayments and incurring legal fees. To minimise the risks associated with the claim recovery process, the Council decided to participate in the auction of Landsbanki claims and received auction proceeds of £1.313m. This brought the claim process to a successful conclusion. The total recovered was £3.069m, which included interest earned on the investment.

The balance sheet value of the Heritable investment at 1 April 2013 was £0.204m. A repayment of £0.337m was received during 2013/14. The balance sheet value was reduced to zero, and £0.133m was transferred to the revenue account. The total repaid to date is £1.894m. The Heritable claim is still continuing, and the balance of £0.121m is outstanding.

Movements in respect of the Heritable and Landsbanki investments are summarised in the table below:-

Icelandic Investments	**Heritable £'000**	**Landsbanki £'000**	**Total £'000**
Original investment	2,000	3,000	5,000
Impairment/accrued interest to 31/3/2013	(239)	(91)	(330)
Cash received to 31/3/2013	(1,557)	(1,587)	(3,144)
Balance Sheet value as at 31/3/2013	**204**	**1,322**	**1,526**
Repaid in 2013/14	(337)	(169)	(506)
Auction proceeds in 2013/14	0	(1,313)	(1,313)
Interest/impairment reduction transferred to revenue account	133	160	293
Balance Sheet value as at 31/3/2014	**0**	**0**	**0**

Economic Background/Interest Rate Forecast

The Council's treasury management advisors Capita Asset Services have provided a review of the year and an interest rate forecast, which is attached as Appendix A.

The interest rate forecast suggests that base rate will not rise from its historic low level of 0.5% until December quarter of 2015.

However, in his Mansion House speech on 12 June 2014, Mark Carney (Governor of the Bank of England) indicated that the first interest rate increase "could happen sooner than markets currently expect". This has prompted speculation in the financial press that the first increase could be before the end of 2014. Mr. Carney stressed that the Bank of England would act cautiously once it started to raise rates to avoid the adverse effects of an excessive or excessively rapid tightening of monetary policy.

WIDER IMPLICATIONS

In the preparation of this report, consideration has been given to the impact of its proposals in all the areas listed below, and the table shows any implications in respect of each of these. The risk assessment which has been carried out forms part of the background papers to the report.

FINANCIAL	As set out in this report and its appendix

LEGAL	Compliance with various Regulations and Statutory Codes of Practice

RISK	The Council's treasury management strategy and policies are designed to ensure the effective control and management of the risks associated with such activities.

THE IMPACT ON EQUALITY	

OTHER (see below)	

Asset Management	*Corporate Plans and Policies*	*Crime and Disorder*	*Efficiency Savings/Value for Money*
Equality, Diversity and Community Cohesion	*Freedom of Information/ Data Protection*	*Health and Safety*	*Health Inequalities*
Human Rights Act 1998	*Implementing Electronic Government*	*Staffing, Training and Development*	*Sustainability*

BACKGROUND DOCUMENTS

Treasury Strategy 2013/14 to 2015/16 (Cabinet 6/2/13)
Treasury Strategy 2014/15 to 2016/17 (Cabinet 12/2/14)

APPENDIX A

Review provided by Capita Asset Services

Economic Background

- After strong UK GDP growth of 0.7%, 0.8% and 0.7% in quarters 2, 3 and 4 respectively in 2013, it appears that strong growth will continue into 2014 as forward surveys are very encouraging. There are also positive indications that recovery is starting to broaden away from reliance on consumer spending and the housing market into construction, manufacturing, business investment and exporting. This strong growth has resulted in unemployment falling much faster towards the threshold of 7%, set by the MPC last August, before it said it would consider any increases in Bank Rate. In the February 2014 Inflation Report, the MPC therefore broadened its forward guidance by adopting five qualitative principles and looking at a much wider range of indicators. Accordingly, markets are expecting a first increase around the end of 2014, though recent comments from MPC members have emphasised they would want to see strong growth well established, and an increase in labour productivity / real incomes, before they would consider raising Bank Rate.

- Also encouraging has been the sharp fall in inflation (CPI), reaching 1.7% in February: forward indications are that inflation will continue to be subdued. The return to strong growth has also helped lower forecasts for the increase in Government debt by £73bn over the next five years, as announced in the Autumn Statement, and by an additional £24bn, as announced in the March 2014 Budget - which also forecast a return to a significant budget surplus, (of £5bn), in 2018-19.

Interest Rate Forecast

The Council's treasury advisor, Capita Asset Services, has provided the following forecast:

	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17
Bank rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.25%	1.50%	1.75%
5yr PWLB rate	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%
10yr PWLB rate	3.70%	3.70%	3.80%	3.80%	3.90%	3.90%	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.50%
25yr PWLB rate	4.40%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%	4.90%	5.00%	5.00%	5.10%	5.10%	5.10%
50yr PWLB rate	4.40%	4.50%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.10%	5.10%	5.20%	5.20%

Capita Asset Services undertook a review of its interest rate forecasts in February, after the Bank of England's latest quarterly Inflation Report. This latest forecast now includes a first increase in Bank Rate in quarter 4 of 2015 (previously quarter 2 of 2016), and reflects greater caution as to the speed with which the MPC will start increasing Bank Rate than the current expectations of financial markets.

SUMMARY OUTLOOK

Until 2013, the economic recovery in the UK since 2008 had been the worst and slowest recovery in recent history. However, growth rebounded during 2013 to surpass all expectations, propelled by recovery in consumer spending and the housing market. Forward surveys are currently very positive in indicating that growth prospects are also strong for 2014, not only in the UK economy as a whole, but in all three main sectors, services, manufacturing and construction. This is very encouraging as there does need to be a significant rebalancing of the economy away from

consumer spending to construction, manufacturing, business investment and exporting in order for this start to recovery to become more firmly established. One drag on the economy was that wage inflation had been significantly below CPI inflation, so disposable income and living standards were being eroded, (although income tax cuts had ameliorated this to some extent). However, the recent fall in inflation has narrowed the gap between wage increases and inflation and this gap could narrow even more during this year, especially if there is also a recovery in growth in labour productivity (leading to significant increases in pay rates). With regard to the US, the main world economy, it faces similar debt problems to those of the UK, but thanks to reasonable growth, cuts in government expenditure and tax rises, the annual government deficit has been halved from its peak without appearing to do too much damage to growth, although labour force participation rates remain lower than ideal.

As for the Eurozone, concerns subsided considerably during 2013. However, sovereign debt difficulties have not gone away and major concerns could return in respect of any countries that do not dynamically address fundamental issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy, (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise to levels that could result in a loss of investor confidence in the financial viability of such countries. This could mean that sovereign debt concerns have not disappeared but, rather, have only been postponed.