Chorley Council

Report of	Meeting	Date
Statutory Finance Officer	Governance Committee	25 June 2014

TREASURY MANAGEMENT ANNUAL REPORT 2013/14

PURPOSE OF REPORT

1. To report on Treasury Management performance and compliance with Prudential Indicators for the financial year ended 31 March 2014.

RECOMMENDATION(S)

2. That the report be noted.

EXECUTIVE SUMMARY OF REPORT

3. This report advises on compliance with Prudential and Treasury Indicators in 2013/14. The return on investments for the year was 1.14%, which exceeded the benchmark. Details of borrowing and investments as at 31 March 2014 are given. In addition, the Icelandic Investment claim has been brought to a conclusion by participation in the auction of claims, and the financial impact is reported.

Confidential report Please bold as appropriate	Yes	**No**

CORPORATE PRIORITIES

4. This report relates to the following Strategic Objectives:

Involving residents in improving their local area and equality of access for all		A strong local economy	
Clean, safe and healthy communities		An ambitious council that does more to meet the needs of residents and the local area	√

BACKGROUND

5. 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 28/2/13), a mid-year review of that strategy (Governance Committee 12/9/2013), and finally this out-turn report.

6. In addition to the three standard treasury reports, the Minimum Revenue Provision Policy for 2014/15 and revised Prudential Indicators were presented to the Council meeting of 11/11/13. It was necessary for Council to approve changes to the MRP Policy and Prudential Indicators prior to the purchase of the Market Walk Shopping Centre.

7. The MRP Policy and Prudential Indicators relevant to 2013/14 were also reported to the Special Council meeting of 25/2/14.

PRUDENTIAL INDICATORS

8. Prudential Indicator: Capital Expenditure and Financing 2013/14

The Council's 2013/14 Capital Programme has been reported to Executive Cabinet and Council at intervals during the year. An analysis of capital expenditure in the year and variances from budgets, including rephasing of expenditure to 2014/15, is given in the report Provisional Revenue and Capital Outturn 2013/14, being presented to the Executive Cabinet meeting of 26 June 2014.

In summary, capital expenditure for 2013/14 was £25.615m compared to the revised budget of £26.583m. Of the total, £23.341m was in respect of the purchase of the Market Walk Shopping Centre in November 2013, which was financed by prudential borrowing. Prudential borrowing of £1.323m was also required to finance other capital investment.

The £0.968m variance from budget at outturn is not an underspend, but is due to the requirement to rephase a number of projects to reflect revised delivery timescales. The recommendation to Executive Cabinet is that the £0.968m should be added to the 2014/15 Capital Programme.

Financing of capital expenditure in 2013/14 and the impact on the Capital Financing Requirement is shown in the table below.

9. Prudential Indicator: Capital Financing Requirement 2013/14

The Capital Financing Requirement is a measure of the capital expenditure incurred by the Council which still has to be paid for. Financing of such expenditure is by a combination of external borrowing, generally loans from the Public Works Loan Board (PWLB), or temporary use of internal cash balances. Ultimately the expenditure 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.

The revised CFR estimated for 2013/14 was £32.518m, therefore the actual CFR is £0.348m more than estimated. This reflects the proposed financing of capital expenditure to be considered by Executive Cabinet. In particular, it is recommended that £0.325m of usable capital receipts be carried forward to 2014/15 to reduce the need to borrow in that financial year, rather than applying the receipts in 2013/14. Such variances in financing take account of the nature of capital expenditure incurred and whether it is appropriate to finance it with prudential borrowing.

Capital Expenditure and Financing	2013/14 £'000
Opening Capital Financing Requirement	**8,472**
Capital investment	
Property, Plant and Equipment	1,650
Investment Properties	23,341
Revenue Expenditure Funded from Capital under Statute	624
Sources of finance	
Capital Receipts	0
Government Grants and Other Contributions	(799)
Sums set aside from revenue	
Revenue Financing	(152)
Minimum Revenue Provision – statutory	(270)
Closing Capital Financing Requirement	**32,866**
Explanation of movements in year	
Increase in prudential borrowing	24,664
Provision made for debt repayment	(270)
Increase/(Decrease) in Capital Financing Requirement	**24,394**

10. Prudential Indicator: The CFR and Borrowing

In order to ensure that local authorities borrow only 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 the next two years. Estimated borrowing at the end of 2013/14 was £30.263m and surplus cash available for investment was £15.000m, giving an estimated net figure of £15.263m compared to the estimated CFR of £32.518m.

The level of borrowing estimated in 2013/14 reflected Council approval to purchase Market Walk and to finance the expenditure with £23.341m prudential borrowing. However, it has proved possible to achieve savings in financing the acquisition by using £10m internal cash balances and taking only £13.341m loans from the PWLB. With interest rates for cash investments remaining low, it was better to use cash balances to avoid borrowing at rates that could have exceeded 4% than to invest at as little as the 0.25% paid by the Debt Management Office.

As a consequence, total borrowing at 31 March 2014 was £22.796m, of which £20.459m was from PWLB and £2.337m was short-term borrowing for cash flow reasons. Cash balances invested at year-end were £3.862m, which meant that borrowing net of investments was £18.934m. The main reason for the increase compared to the estimate was the temporary borrowing required at year-end.

11. Compliance with Borrowing Limits (Operational Boundary & Authorised Limit)

The Prudential Indicators include two borrowing limits: the Operational Boundary, which reflects the expected borrowing position; and the Authorised Limit, which provided headroom to cater for unanticipated cash movements.

The revised Operational Boundary for 2013/14 was set at £30.277m, which included £30.263m external borrowing plus £0.014m other long-term liabilities. The actual total for the year was £22.811m, and the reason for the reduction was the use of internal cash balances rather than external borrowing to finance the acquisition of Market Walk for the time being.

The revised Authorised Limit was set at £32.277m, to allow a margin for temporary borrowing. Actual borrowing and other long-term liabilities were £22.811m and therefore were below the limit.

12. Prudential Indicator: Ratio of Financing Costs to the Revenue Stream

This indicator identifies the percentage of the Council's income from Government grants and Council Tax that has been used to meet interest costs and debt repayment (MRP). The estimated figure reported in the Treasury Strategy 2014/15 was 2.10%. The actual ratio has increased slightly to 2.24%, the main reason being the interest on borrowing to finance Market Walk (four months) being included in the financing costs. However, the rental income from retail premises is not included in the definition of the rental stream. The fact that Market Walk earned a surplus of £0.326m after taking account of financing costs cannot be reflected in the calculation of this prudential indicator.

13. Prudential Indicator: Incremental Impact of Capital Investment Decisions

This indicator is concerned with the cumulative impact on the revenue budget of capital expenditure over a number of years. It is not possible to give a meaningful comparison against this indicator, other than when it is restated each year in the Treasury Strategy.

14. Treasury Position as at 31 March 2014

	As last reported (in 2014/15 Treasury Strategy) **£'000**	**Actual value as at 31 March 2014** **£'000**
Borrowing at period start	7,272	7,272
Borrowing repaid in year	(350)	(349)
Borrowing in year	23,341	15,678
Total borrowing at period end **	**30,263**	**22,601**
** Excluding accrued interest		
Cash & investments	**(15,000)**	**(3,862)**
Net Borrowing	**15,263**	**18,739**

15. Treasury Indicator: Upper Limit on Fixed Interest Rate Exposure

The Council is exposed to fixed interest rates on its borrowings. The upper limit on fixed interest rate exposure for 2013/14 was set at 100%, that is equivalent to the Operational Boundary. The limit was not breached.

16. Treasury Indicator: Upper Limit on Variable Interest Rate Exposure

The Council is exposed to variable interest rates on cash invested temporarily in money market funds and call accounts. The table below shows that on average £3.162m was invested each day in such funds. The upper limit on variable rate exposure for 2013/14 was set at £25m.

17. Investments and Average Rate Achieved

The following table summarises investment activity and returns during 2013/14:

Details	Average daily Investment £'000	Interest Earned £	Average Rate %
Money Market Funds	586	2,491	0.43
Call accounts	2,576	18,363	0.71
Sub Total – MMF/Call accounts	**3,162**	**20,854**	
Short Term deposits	9,658	125,604	1.30
Debt Management Office (DMO)	0	0	0.00
Total	**12,820**	**146,458**	**1.14**

The average interest earned of 1.19% exceeded the performance benchmark of 0.34%, being the 7-day London Inter-Bank Bid Rate (LIBID). However, the average rate achieved has fallen compared to 2012/13, when 1.42% was achieved and the 7-day LIBID was 0.39%. The likelihood is that the average rate achieved in 2014/15 will remain low, which tends to support the strategy of using internal cash balances to avoid taking additional borrowing to finance Market Walk.

The interest earned total of £0.146m does not include monies credited to the revenue account arising from the auction of the Council's Icelandic investment.

18. Icelandic Investment

At the start of 2013/14, the impaired balance sheet value of the Council's investment in Landsbanki was £0.830m. During the year, the Winding-Up Board made one repayment of £0.102m, reducing the balance sheet value of the investment to £0.728m.

Recovery of the balance of the investment was expected to take several years, and would involve exchange rate losses and incurring of legal fees. To minimise the risks associated with the recovery process, the Council decided to participate in the auction of Landsbanki claims, and received auction proceeds of £0.792m. This brought the claim process to a conclusion, summarised as follows:

Icelandic Investment	£'000
Original investment	2,000
Impairment/accrued interest to 31/3/2013	(208)
Cash received to 31/3/2013	(962)
Owing as at 31/3/2013	**830**
Received from Winding-Up Board in 2013/14	(102)
Auction proceeds in 2013/14	(792)
Interest/impairment reduction transferred to revenue account	64
Owing as at 31/3/2014	**0**

The total recovered was £1.856m or 93% of the original investment.

19. 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.

Capita Asset Services expect PWLB rates to increase from the September quarter of 2014. At some stage it may be advisable for the Council to take further PWLB loans before longer-term rates increase significantly, in order to achieve certainty of capital financing costs.

IMPLICATIONS OF REPORT

20. This report has implications in the following areas and the relevant Directors' comments are included:

Finance	√	Customer Services	
Human Resources		Equality and Diversity	
Legal		Integrated Impact Assessment required?	
No significant implications in this area		Policy and Communications	

COMMENTS OF THE STATUTORY FINANCE OFFICER

21. This report meets statutory reporting requirements. Its statistical content is consistent with the Council's unaudited financial accounts for the financial year 2013/14.

COMMENTS OF THE MONITORING OFFICER

22. The Monitoring Officer has no comments.

GARY HALL
CHIEF EXECUTIVE & STATUTORY FINANCE OFFICER

Background Papers			
Document	**Date**	**File**	**Place of Inspection**
Treasury Strategy 2013/14 Treasury Strategy 2014/15	28/2/13 25/2/14		Town Hall

Report Author	Ext	Date	Doc ID
Michael Jackson	5490	11 June 2014	Treasury Management Annual Report 2013-14.docx

APPENDIX A

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.