

Status of Report:

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Agenda Item:

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**Meeting:** Overview and Scrutiny Committee  
**Date:** 19<sup>th</sup> November 2014  
**Subject:** Annual Treasury Management Report 2013/14  
**Report by:** The Treasurer  
**Author:** Philippa Brown (Accountant)  
**For:** Discussion

### 1. Purpose

The Combined Fire Authority (CFA) is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2013/14. This report meets both the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

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

- an annual treasury strategy in advance of the year (CFA - 13<sup>th</sup> February 2013)
- a mid-year (minimum) treasury update report (CFA - 11<sup>th</sup> December 2013)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

The regulatory environment places responsibility on Members for the review and scrutiny of treasury management policy and activities. This report is therefore important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the CFA's policies previously approved by members.

The CFA also confirms that it will comply with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Overview and Scrutiny Committee before they are reported to the CFA. Member training on treasury management issues was undertaken during the year on the 11<sup>th</sup> December 2013 in order to support Members' scrutiny role.

The purpose of this report is to meet one of the above requirements of the CIPFA Code, namely the annual review report of treasury management activities.

## 2. Executive Summary

This 2013/14 Annual Treasury Report covers:

- the economy and interest rates
- the CFA's treasury position as at the 31<sup>st</sup> March 2014
- the strategy for the year
- the borrowing requirement and debt
- borrowing rates
- the borrowing outturn position
- investment rates
- investment outturn
- performance measurement.

## 3. Report Detail

### **The Economy and Interest Rates**

**3.1** The financial year 2013/14 continued the challenging investment environment of previous years, namely low investment returns, although levels of counterparty risk had subsided somewhat. The original expectation for 2013/14 was that Bank Rate would not rise during the year and for it only to 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 no additional quantitative easing during 2013/14 and the Bank Rate ended the year unchanged at 0.5% for the fifth successive year. While Consumer Price Index (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.

Gilt yields were on a sharply rising trend during 2013 but volatility returned in the first quarter of 2014 as various fears sparked a flight to quality (see paragraph 4.) The Funding for Lending Scheme, announced in July 2012, resulted in a flood of cheap credit being made available to banks which then resulted in money market investment rates falling drastically in the second half of that year and continuing into 2013/14. That 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.

The UK coalition Government maintained its tight fiscal policy stance but recent strong economic growth has led to a cumulative (in the Autumn Statement and the March Budget) reduction in the forecasts for total borrowing, of £97bn over the next five years, culminating in a £5bn surplus in 2018/19.

The EU sovereign debt crisis subsided during the year and confidence in the ability of the Eurozone to remain intact increased substantially. Perceptions of counterparty risk improved after the European Central Bank (ECB) statement in July 2012 that it would do "whatever it takes" to support struggling Eurozone countries; this led to a return of confidence in its banking system which has continued into 2013/14 and led to a move away from only very short term investing. However, this is not to say that the problems

of the Eurozone, or its banks, have ended as the zone faces the likelihood of weak growth over the next few years at a time when the total size of government debt for some nations is likely to continue rising. The stress tests of Eurozone banks have revealed some areas of concern.

### **Overall Treasury Position as at the 31st March 2014**

3.2 At the beginning and the end of 2013/14 the CFA's treasury position was as follows:

TABLE 1	31 <sup>st</sup> March 2013 Principal	Rate/ Return	Average Life yrs	31 <sup>st</sup> March 2014 Principal	Rate/ Return	Average Life yrs
	£m	%		£m	%	
<b>Public Works Loans Board (PWLB) Debt</b>	11.228	3.77	22	16.728	3.77	20
<b>Finance Leases</b>	5.977	3.40	7	6.615	3.72	6
<b>Capital Financing Requirement (CFR)</b>	<b>19.799</b>			<b>22.595</b>		
<b>Over / (under) borrowing</b>	<b>(2.594)</b>			<b>748</b>		
<b>Total investments</b>	2.342	1.19		4.385	0.58	
<b>Net Debt</b>	<b>14.863</b>			<b>18.958</b>		

### **The Strategy for 2013-14**

3.3 The expectation for interest rates within the strategy for 2013/14 anticipated a low but rising Bank Rate (starting in quarter 1 of 2015), and gradual rises in medium and longer term fixed borrowing rates during 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.

In this scenario, the treasury strategy was to postpone borrowing where possible to avoid the cost of holding higher levels of investments and to reduce counterparty risk.

The actual movement in gilt yields meant that Public Works Loans Board (PWLB) rates were on a sharply rising trend during 2013 as markets anticipated the start of tapering of asset purchases by the US Federal Open Market Committee (the Fed). This duly started in December 2013 and the Fed adopted a future course of monthly reductions of \$10bn (from a starting position of \$85bn) meaning that asset purchases were likely to stop by the end of 2014. However, volatility set in during the first quarter of 2014 as fears around emerging markets, various vulnerabilities in the Chinese economy, the increasing danger for the Eurozone to drop into a

deflationary spiral, and the situation in the Ukraine, caused rates to dip down, reflecting a flight to quality into UK gilts.

**Change in strategy during the year** – no changes have been required to the strategy which was set in the Medium Term Financial Plan on the 13<sup>th</sup> February 2013.

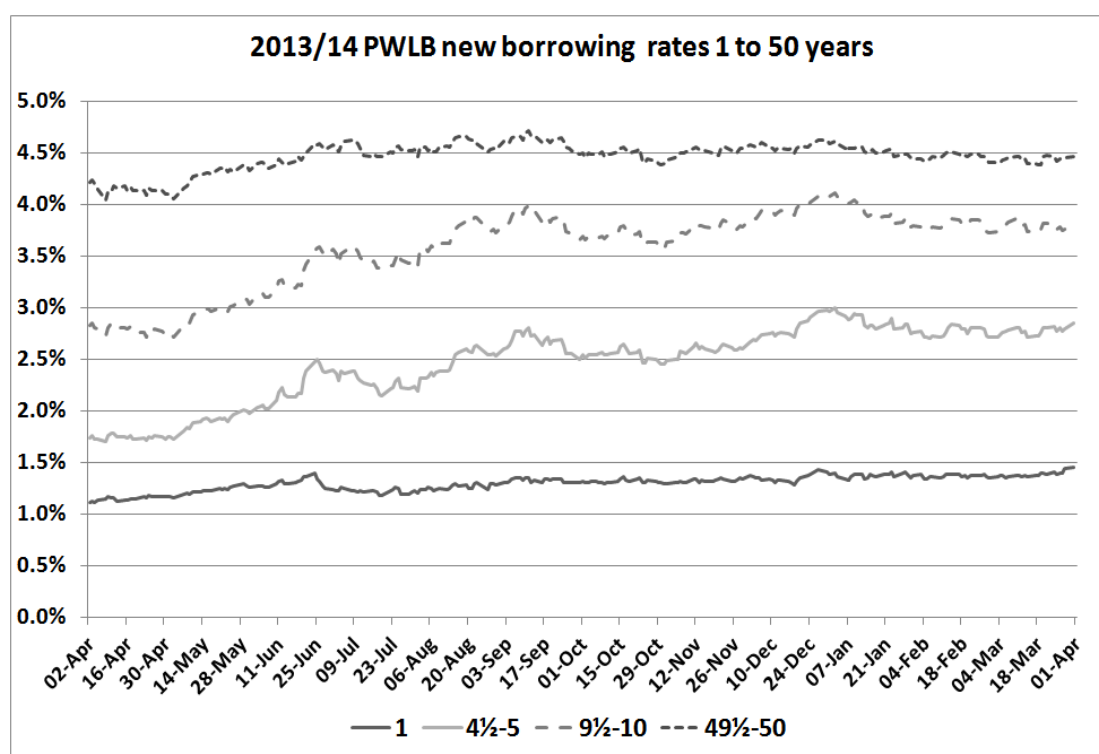
**The Borrowing Requirement and Debt**

3.4 The CFA’s underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).

	31 March 2013 Actual £m	31 March 2014 Budget £m	31 March 2014 Actual £m
Capital Financing Requirement	19.799	28.605	22.595

**Borrowing Rates in 2013/14**

3.5 **PWLB borrowing rates** - the graph below shows how PWLB certainty rates have risen from historically very low levels during the year.



Graph showing rates for new borrowing, by maturity periods in years.

**Borrowing Outturn for 2013-14**

3.6 The following loans were taken during the year:

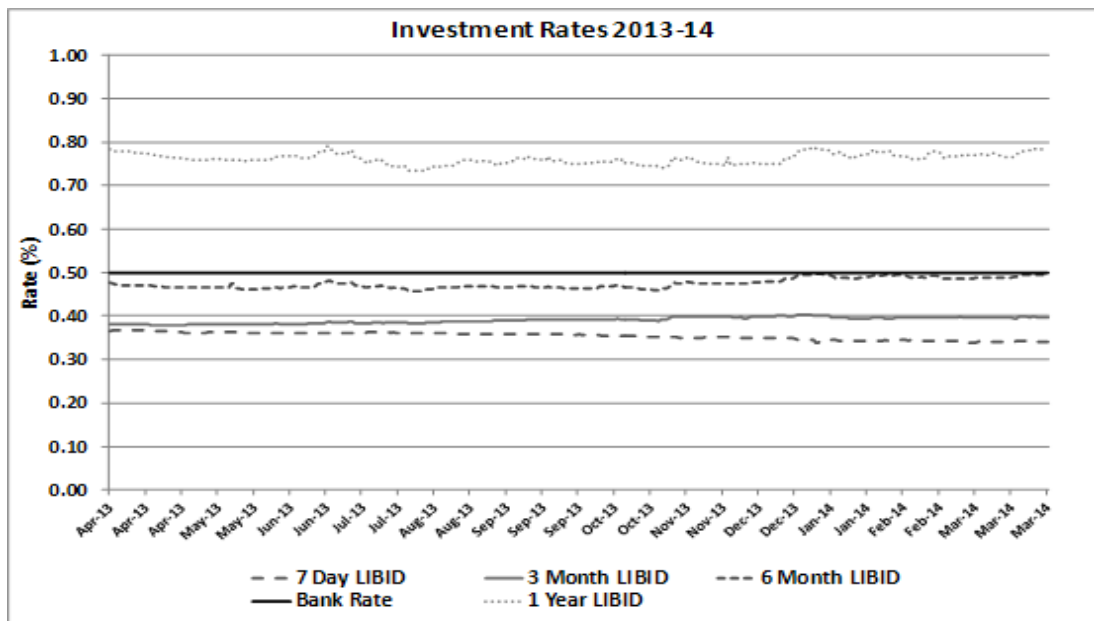
Lender	Principal	Type	Interest Rate	Maturity
	£m		%	
PWLB	0.750	Fixed interest rate	3.98	14 years
PWLB	0.750	Fixed interest rate	2.90	6 years
PWLB	2.000	Fixed interest rate	3.77	11 years
PWLB	2.000	Fixed interest rate	3.98	15 years
Market	1.424	Fixed interest rate	1.86	10 years

This compares with a budget assumption of borrowing at an interest rate of 5.2%. The CFA continued to be eligible to access PWLB certainty rate which resulted in all PWLB borrowing being 0.2% below the PWLB quoted rates.

**Debt Rescheduling** - no rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

**Investment Rates in 2013-14**

3.7 The Bank Rate remained at its historic low of 0.5% throughout the year; it has now remained unchanged for five years. Market expectations as to the timing of the start of monetary tightening ended up unchanged at early 2015. The Funding for Lending Scheme resulted in deposit rates remaining depressed during the whole of the year, although the part of the scheme supporting provision of credit for mortgages came to an end in the first quarter of 2014.



### **Investment Outturn For 2013-14**

- 3.8 **Investment Policy** – the CFA's investment policy is governed by the Department for Communities and Local Government's (DCLG's) guidance, which was been implemented in the annual investment strategy approved by the CFA on the 11<sup>th</sup> February 2014. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc.).

Due to the continuing limited list of counterparties, and the fact that most require a minimum of £1m as an investment, it has continued to be problematic to maintain percentage balances of less than 50%. In the year to the 31<sup>st</sup> March, 11 days were over 50% with total balances in the £5-£6m range, 9 days were over 50% with total balances in the £6-£7m range, 16 days in the £7-£8m range and 5 days in the £8-£9m range. This will continue to be monitored and reported.

**Investments held by the CFA** - the CFA maintained an average balance of £5.088m of internally managed funds. The internally managed funds earned an average rate of return of 0.58%. The comparable performance indicator is the average 7-day LIBID, which was 0.356%. This compares with a budget assumption of £6.119m investment balances earning an average rate of 1.0%.

### **Prudential and Treasury Indicators**

- 3.9 The CFA's indicators are set out in **the Appendix**.

## **4. Report Implications / Impact**

### **4.1 *Legal (including crime and disorder)***

None.

### **4.2 *Financial (including value for money, benefits and efficiencies)***

These are contained within the main body of this report.

### **4.3 *Risk (including corporate and operational, health and safety and any impact on the continuity of service delivery)***

It is important to be aware of risk in respect of Treasury Management activities, both in investing and borrowing. The CFA has retained Capita as Treasury Management advisors to ensure that the CFA's treasury activities are appropriate.

### **4.4 *Staff, Service Users and Stakeholders (including the Equality Impact Assessment)***

None.

### **4.5 *Environmental***

None.

#### **4.6 *Impact upon Our Plan Objectives***

None.

#### **5. Recommendations**

The Overview and Scrutiny Committee are asked to note the Annual Treasury Report for 2013-14.

#### **6. Background Papers**

- a) Medium Term Financial Plan 2014-17 (CFA Report - 12<sup>th</sup> February 2014)
- b) Treasury Management mid-year review report 2013/14 (CFA Report – 11<sup>th</sup> December 2013)
- c) Medium Term Financial Plan 2013-16 (CFA Report - 13<sup>th</sup> February 2013)

#### **7. Appendix**

Prudential and Treasury Indicators

**Prudential and treasury indicators**

<b>1. PRUDENTIAL INDICATORS</b>	<b>2012-13</b>	<b>2013-14</b>	<b>2013-14</b>
<b>Extract from budget setting report</b>	<b>actual £'000</b>	<b>original £'000</b>	<b>actual £'000</b>
<b>Capital Expenditure</b>	12,949	8,733	8,316
<b>Ratio of financing costs to net revenue stream</b>	4.54%	6.63%	5.87%
<b>Gross borrowing requirement</b>			
brought forward 1 April	5,683	20,197	17,456
carried forward 31 March	17,456	25,300	22,594
in year borrowing requirement	11,773	5,103	5,138
<b>Gross debt</b>	17,205	29,817	23,343
<b>CFR</b>	19,799	28,605	22,594
<b>Annual change in Cap. Financing Requirement</b>	5,408	3,829	2,795
<b>Incremental impact of capital investment decisions</b>	<b>£ p</b>	<b>£ p</b>	<b>£ p</b>
Increase in council tax (band D) per annum	5.17	8.53	7.55



<b>2. TREASURY MANAGEMENT INDICATORS</b>	<b>2012-13</b>	<b>2013-14</b>	<b>2013-14</b>
	<b>revised</b>	<b>original</b>	<b>revised</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
<b>Authorised Limit for external debt -</b>			
borrowing	26,619	25,269	25,269
other long term liabilities	6,092	8,336	8,336
<b>TOTAL</b>	<b>32,711</b>	<b>33,605</b>	<b>33,605</b>
<b>Operational Boundary for external debt -</b>			
borrowing	22,215	22,769	22,769
other long term liabilities	6,092	7,836	7,836
<b>TOTAL</b>	<b>28,307</b>	<b>30,605</b>	<b>30,605</b>
<b>Actual external debt</b>	17,205		23,343
<b>Upper limit for fixed interest rate exposure</b>			
Net principal re fixed rate borrowing / investments	100%	100%	100%
<b>Upper limit for variable rate exposure</b>			
Net principal re variable rate borrowing/ investments	50%	50%	50 %
<b>Upper limit for total principal sums invested for over 364 days</b> (per maturity date)	35%	35%	35%

<b>Maturity structure of fixed rate borrowing during 2013/14</b>	<b>upper limit</b>	<b>lower limit</b>
under 12 months	30%	0%
12 months and within 24 months	30%	0%
24 months and within 5 years	30%	0%
5 years and within 10 years	30%	0%
10 years and above	100%	25%