Report

Audit Committee

Part 1

Item No 6

16 July 2015

Subject	**Report on Treasury Management covering the Financial Year 2014/15**
Purpose	To inform Audit Committee of treasury activities undertaken during the financial year 2014/15.
Author	Assistant Head of Finance
Ward	General
Summary	During the year to 31 March 2015, the Council continued to invest surplus funds with its own bankers (Santander), and institutions with long-term credit ratings in at least the 'A-' Category. As at 31 March 2015, the Council has short-term investments of £2.560m, this was to invest surplus funds that had come into the Council on over a minimal timescale. Temporary borrowing has continued to be required to fund normal day to day activities. All borrowing undertaken was as expected, and within the Council's agreed limits.
Proposal	**1.To note the Annual Report on Treasury Management for the Financial Year 2014/15.** **2. To note that 2014/15 Prudential Indicators for Treasury Management were in line with those initially set.**

Action by Head of Finance
Timetable For the periods indicated.

This report was prepared after consultation with:

- Treasury Advisors
- Head of Finance

Background

1. The Authority's treasury management activity is underpinned by CIPFA's Code of Practice on Treasury Management ("the Code"), which requires 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.

2. This report fulfils the Authority's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the Welsh Government's Investment Guidance.

3. The Authority has borrowed substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Authority's treasury management strategy.

4. The 2014/15 Treasury Management Strategy was approved by the Council as part of the overall Medium Term Financial Plan and 2014/15 budget in February 2014.

5. This report presents the following information.

    - details of capital financing, borrowing, debt rescheduling and investment transactions
    - reports on the risk implications of treasury decisions and transactions
    - details the outturn position on treasury management transactions in 2014/2015
    - confirms compliance with treasury limits and Prudential code

Annual Review Report 2014/15

Short and Long Term Borrowing

6. In recent years the Council's strategy has been to fund capital expenditure from reducing investments rather than undertaking more expensive new long term borrowing. This is because the rates achievable on the Council's investments are lower than the rates that would be payable on long term borrowing. By using this strategy the Council can minimise cash holding at a time when counterparty risk remains high. The Councils short term cash requirements are dealt with by short term loans when required. In any month, the Council is both a short-term investor and short-term borrower as it is required to maintain low cash holdings, whilst holding off the need for long-term borrowing.

7. Whilst the strategy minimises investment counterparty risk, the risk of interest rate exposure is increased as the current low longer term borrowing rates may rise in the future. The market position is being constantly monitored in order to minimise this risk.

8. As anticipated, the Council has had to undertake short-term borrowing in order to cover normal day to day cash flow activity. Total temporary borrowing of £116.1million was raised during the year, of which £10.0million remained outstanding at the 31 March 2015.

9. During 2014/15 the Council has also been required to undertake additional long term borrowing of £34.97million associated with city centre redevelopment funding of the approved loan to Queensberry Real Estates (Newport) Ltd (QRE). The borrowing associated with this loan is kept separate from the Council's other borrowing requirements as shown in Table 1. The loan is anticipated to be paid off via capital receipts in 2016/17, therefore the Council is not required to make MRP charges to the revenue budget in relation to the Friars Walk Development loan as the borrowing will be paid off in full at the end of the scheme.

10. With the exception of the Queensberry loans discussed above, no further long-term loans were taken out during 2014-15. A total of £2.293million of long-term loans were

repaid and were not further re-financed. A total of £180.41million of long-term loans were outstanding as at 31 March 2015.

11. Total borrowing has remained within the approved limits for external debt as shown in Appendix C and Table 1 to this report compares borrowings and investments as at 31 March 2014 and 2015, showing an increase to net borrowing of £31.98million.

12. Appendix A summarises the loan debt activity for 2014/15. The key points to note are:

- the average rate of interest on debt was 6.03% compared with 5.37% for the previous year.
- Long-term loan repayments in 2014/15 totalled £2.293million.

13. During 2014/15 a review of long term debt was completed, it was determined that a restructure of these debts take place in 2015/16, this was implemented in early April. This will be reported on in the mid-year report in November.

Future Council borrowing requirements

14. Local Authorities measure their underlying need for long-term borrowing through their 'Capital Financing Requirement' (CFR). This takes into account the amount of planned capital expenditure that needs to be funded through borrowing, (as opposed to external funding - from cash grants, capital receipts or S106 contributions for example) irrespective of whether the borrowing itself is undertaken externally or through dis-investing. The total additional capital expenditure that needs to be funded from borrowing planned for 2015/16 for the Council's capital programme is £19.107million. A further £45.0million borrowing is expected in relation to the Queensberry loan.

15. Table 2 shows the current and projected CFR for the Council which is reviewed and updated on an on-going basis. As the Council and Cabinet are regular advised, there is a significant inherent 'need to borrow' as shown by the CFR. This is predicted to be £368.09million by the end of 2015/16, whereas existing long term borrowing is £236.54million. After taking account of cash backed reserves this reduced the requirement of additional borrowing to £52.8million in 2015/16. This figure includes anticipated borrowing of £45.0million in relation to the Queensberry Real Estate (Newport) Ltd loan that will fall into the 2015/16 financial year.

16. In January 2015 the Department of Communities and Local Government (CLG) confirmed that HM Treasury (HMT) would be taking the necessary steps to abolish the Public Works Loans Board. HMT has confirmed however that its lending function will continue unaffected and local authorities will retain access to borrowing rates which offer good value for money. The authority intends to use the PWLB's replacement as a potential source of borrowing if required.

Investments

17. As per the agreed strategy, the Council will be a short-term investor to maintain low cash balances as required, by 31 March 2015 these valued £2.56million due to funds received by the Council which were invested on overnight terms.

18. Interest rates remained at a historically low level of 0.5% throughout the year. Within this economic environment, the Councils approved Treasury Strategy was to reduce investments held, rather than increase borrowing. This strategy was driven by the gap between investment rates of below 1% and borrowing rates of around 2%-5%.

19. The average interest rate achieved on the Council's short-term investments was 0.97%, Whilst this return is above our target rate of 0.5%, the difference is much closer than in previous years, the following issues account for this:

- the restricted number of institutions that the Council could lend to;

- the availability of call accounts with institutions on the approved lending list which paid above base rate

20. The Council held no long-term (more than 364 days) investments at 31st March 2015.

21. Security of capital remained the Council's main investment objective. This was maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2014/15. Investments during the year included:

    - Deposits with the Debt Management Agency
    - Deposits with other public institutions such as local authorities, police and fire authorities
    - Call accounts and deposits with banks and a single building society all considered systemically important to the UK banking system

22. The period has shown robust growth of the GDP and labour market improvements. However uncertainty remains across the Eurozone, these are outlined in detail at Appendix B.

Credit Risk

23. Counterparty credit quality was assessed and continually monitored in conjunction with Arlingclose. Factors taken into account included:

    - Credit ratings (the minimum long term rating was A- across all three rating agencies (Fitch, Moody's and Standard and Poors)
    - Credit default swops
    - The GDP of the country in which the institution is domiciled
    - That country's net debt as a percentage of the GDP
    - Likely support mechanisms from within the country
    - Share prices where available

24. All of these factors were continually assessed and changes were made as needed to the Council's approved lending list by either suspending any institutions affected temporarily or permanently and/or by varying the amount and time limits for lending.

Table 1- Treasury Portfolio 2014-2015

31/03/2014 **£m**		**31/03/2015** **£m**
	External Borrowing:	
(72.23)	Public Work Loan Board	(70.13)
(35.00)	Market Loans (Loans held with various Financial Organisations. Maturity dates range from 2042 – 2078)	(35.00)
(40.00)	Newport City Stock Issue (Bonds paying interest at 8.8% with a maturity date of 2019)	(40.00)
(5.86)	Temporary Borrowing	(10.00)
0	Queensberry Borrowing	(34.97)
(0.50)	Other Loans (IFRS)	(0.30)
(153.59)	**Total Loan Debt**	**(190.40)**
(53.43)	Other Long Term Liabilities (including PFI schemes)	(51.16)
(207.02)	**Total External Debt**	**(241.56)**
0.00	Investments Managed in house	2.56
(207.02)	**(Net Borrowing) Net Investment Position**	**(239.00)**

Table 2 -Capital Financing Requirement

Newport City Council Gross to Net Borrowing Requirement (Projections)				
	31-Mar-15	31-Mar-16	31-Mar-17	31-Mar-18
Gross CFR	320,600	368,086	285,140	287,778
Less: Deferred Liabilities (nominal value)	-51,161	-49,044	-46,838	-44,592
Borrowing CFR	**269,439**	**319,042**	**238,302**	**243,186**
Less: External Borrowing (nominal value)	**-185,375**	**-187,290**	**-183,689**	**-180,088**
Gross Borrowing Requirement/Internal Borrowing	**84,064**	**131,752**	**54,613**	**63,098**
Less: Usable Reserves	-89,827	-78,960	-78,811	-78,116
Net Borrowing Requirement/ -Investment Capacity	**-5,763**	**52,792**	**-24,198**	**-15,018**

Cash & Investments	-7,776
Net Debtors/ -Creditors	13,539
Total	**5,763**

- Gross CFR – This is calculated based on the Capital Assets held by the Council plus any planned additional capital expenditure during the year.
- Deferred Liabilities – This is calculated based on actual PFI Schemes and Finance lease liabilities, plus any planned new leases or schemes for each year.
- External Borrowing – This is calculated based on actual borrowing, plus any planned borrowing for each financial year.
- Useable Reverses – This is calculated based on actual reserve balances, plus any planned movements for each financial year.

Advisors

25. Arlingclose were the Council’s treasury management advisors during 2014/15. In that period, the service provided by Arlingclose continued to meet the requirements of the tender and our expectations.

Prudential Code Indicators

26. Appendix C to this report summarises the prudential code indicators relevant to Treasury Management for 2014/15 as previously set and compares them to the actual position. The figures indicate that the Council was in compliance with all of the indicators in 2014/15.

Risks

Risk	Impact of Risk if it occurs* (H/M/L)	Probability of risk occurring (H/M/L)	What is the Council doing or what has it done to avoid the risk or reduce its effect	Who is responsible for dealing with the risk?
Investment counterparty not repaying investments	High but depending on investment value	Low	The Council only invests with Institutions with very high credit scores. It employs advisors to monitor moneymarket movements and changes to credit scores and acts immediately should things change adversely. The lower levels of funds available for investment will also alleviate the risk.	Head of Finance, Treasury staff, treasury advisors
Interest Rates moving adversely against expectations	Low	Low	Base and short term Interest rates are expected to remain at current levels for at least a year. The Treasury strategy approved allows for the use of short term borrowing once investment funds are exhausted to take advantage of these low rates.	Head of Finance, Treasury staff, treasury advisors

* Taking account of proposed mitigation measures

Links to Council Policies and Priorities
It is the Council's policy to ensure that the security of the capital sums invested is fully recognised and has absolute priority. The Council follows the advice of the Welsh Assembly Government that any investment decisions take account of security, liquidity and yield in that order.

Options Available
The Prudential Code and statute requires that, during and at the end of each financial year, reports on these matters are presented to members for consideration. Thus the only option available is to consider this report.

Preferred Option and Why
The preferred choice is to receive and note the contents of the report.

Comments of Monitoring Officer
There are no legal implications. The in year and annual treasury management report is consistent with relevant Chartered Institute of Public Finance and Accountancy Guidance, Treasury Management principles and the Council's Investment Strategy.

Staffing Implications :Comments of Head of Human Resources and Policy

There are no human resources implications within the report

Comments of Cabinet Member
Not applicable

Consultation
As per report

Background Papers

Credit Rating Data received via Arlingclose

Report to Cabinet February 2014: Medium Term Financial Plan and 2014/15 budget

Report on Treasury Management for the period to 30 September 2014

List of Appendices

Appendix A – Loan Debt Activity 2014/2015
Appendix B – Economic Summary 2014/2015
Appendix C – Prudential Code – Review of 2014/2015 Treasury Management Indicators

Dated : 16 July 2015

APPENDIX A

LOAN DEBT AND INVESTMENT ACTIVITY 2014/15 FINANCIAL YEAR

Newport City Council Debt	Outstanding as at 01/04/14	Raised	Repaid	Outstanding as at 31/03/2015
	£000s	£000s	£000s	£000s
Public Works Loans Board	72,233	-	(2,102)	70,131
Market Loans	35,000	-	-	35,000
Stock Issue	40,000	-	-	40,000
Queensberry Borrowing		34,975	-	34,975
Other Loans (IFRS)	495	-	(191)	304
Total Long Term Loans	147,728	34,975	(2,293)	180,410
Temporary Debt	5,860	116,110	(111,970)	10,000
Total Long Term and Temporary Debt	153,588	151,085	(114,263)	190,410

Total Debt Administered Newport City Council & Other Authorities	Outstanding as at 01/04/14	Raised	Repaid	Outstanding as at 31/03/2015
	£000s	£000s	£000s	£000s
Loans	153,588	151,085	(114,263)	190,410

Total Investments Administered Newport City Council	Outstanding as at 01/04/14	Raised	Repaid	Outstanding as at 31/03/2015
	£000s	£000s	£000s	£000s
Investments	-	306,595	(304,035)	2,560

Appendix B

ECONOMIC ACTIVITY REVIEW – 2014/15

Growth and Inflation: The robust pace of GDP growth of 3% in 2014 was underpinned by a buoyant services sector, supplemented by positive contributions from the production and construction sectors. Resurgent house prices, improved consumer confidence and healthy retail sales added to the positive outlook for the UK economy given the important role of the consumer in economic activity.

Annual CPI inflation fell to zero for the year to March 2015, down from 1.6% a year earlier. The key driver was the fall in the oil price (which fell to $44.35 a barrel a level not seen since March 2009) and a steep drop in wholesale energy prices with extra downward momentum coming from supermarket competition resulting in lower food prices. Bank of England Governor Mark Carney wrote an open letter to the Chancellor in February, explaining that the Bank expected CPI to temporarily turn negative but rebound around the end of 2015 as the lower prices dropped out of the annual rate calculation.

Labour Market: The UK labour market continued to improve and remains resilient across a broad base of measures including real rates of wage growth. January 2015 showed a headline employment rate of 73.3%, while the rate of unemployment fell to 5.7% from 7.2% a year earlier. Comparing the three months to January 2015 with a year earlier, employee pay increased by 1.8% including bonuses and by 1.6% excluding bonuses.

UK Monetary Policy: The Bank of England's MPC maintained interest rates at 0.5% and asset purchases (QE) at £375bn. Its members held a wide range of views on the response to zero CPI inflation, but just as the MPC was prepared to look past the temporary spikes in inflation to nearly 5% a few years ago, they felt it appropriate not to get panicked into response to the current low rate of inflation. The minutes of the MPC meetings reiterated the Committee's stance that the economic headwinds for the UK economy and the legacy of the financial crisis meant that increases in the Bank Rate would be gradual and limited, and below average historical levels.

Political uncertainty had a large bearing on market confidence this year. The possibility of Scottish independence was of concern to the financial markets, however this dissipated following the outcome of September's referendum. The risk of upheaval (the pledge to devolve extensive new powers to the Scottish parliament; English MPs in turn demanding separate laws for England) lingers on. The highly politicised March Budget heralded the start of a closely contested general election campaign and markets braced for yet another hung parliament.

On the continent, the European Central Bank lowered its official benchmark interest rate from 0.15% to 0.05% in September and the rate paid on commercial bank balances held with it was from -0.10% to -0.20%. The much-anticipated quantitative easing, which will expand the ECB's balance sheet by €1.1 trillion was finally announced by the central bank at its January meeting in an effort to steer the euro area away from deflation and invigorate its moribund economies. The size was at the high end of market expectations and it will involve buying €60bn of sovereign bonds, asset-backed securities and covered bonds a month commencing March 2015 through to September 2016. The possibility of a Greek exit from the Eurozone refused to subside given the clear frustrations that remained between its new government and its creditors.

The US economy rebounded strongly in 2014, employment growth was robust and there were early signs of wage pressures building, albeit from a low level. The Federal Reserve made no change to US policy rates. The central bank however continued with 'tapering', i.e. a reduction in asset purchases by $10 billion per month, and ended them altogether in October 2014. With the US economy resilient enough the weather the weakness of key trading partners and a strong US dollar, in March 2015 the Fed removed the word “patient” from its statement accompanying its rates decisions, effectively leaving the door open for a rise in rates later in the year.

Market reaction: From July, gilt yields were driven lower by a combination of factors: geo-political risks emanating from the Middle East and Ukraine, the slide towards deflation within the Eurozone and the big slide in the price of oil and its transmission though into lower prices globally. 5-, 10- and 20-year gilt yields fell to their lows in January (0.88%, 1.33% and 1.86% respectively) before ending the year higher at 1.19%, 1.57% and 2.14% respectively.

Appendix C

PRUDENTIAL CODE – REVIEW OF 2014/2015 TREASURY MANAGEMENT INDICATORS

The CIPFA Prudential Code covers the control of capital expenditure and Treasury Management issues. This report deals with the Treasury Management aspects of the Code. The Code requires actual outturn against the Indicators set under the Code to be reported to Council.

The original indicators for 2014/15 were agreed by Cabinet/Council in February 2014. The following lists each of the indicators and provides the actual position against each, with comments to explain any significant variation.

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 it's financing.

	Estimate £million
Set in February 2014	350.600
Actual at 31 March 2015	320.600

Fixed and Variable Rate Limits

These indicators set upper limits that apply to the amounts outstanding on both fixed and variable interest rates. The indicators set and actual at 31 March 2015 were:

	Fixed %	Variable %
Set in February 2014	100	50
Actual at 31 March 2015	100	0

The indicators set upper and lower limits (expressed as a percentage) to the amount of borrowing the Council was prepared to have outstanding in various set periods. The following table shows firstly the levels set in February 2014 and applicable throughout 2014/15 and then the actual position based on debt outstanding at 31 March 2015.

	Indicator Set		Actual
	Upper Limit %	Lower Limit %	%
Under 12 months	40	0	7
12 months and within 24 months	20	0	1
24 months and within 5 years	50	0	46
5 years and within 10 years	50	0	9
10 years and within 20 years	20	0	7
20 years and within 30 years	20	0	9
30 years and within 40 years	20	0	3
40 years and within 50 years	20	0	10
50 years and above	20	0	8

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.

	Total
Indicator Set	5,000,000
Actual at 31 March 2015	0

Authorised Limit and Operational Boundary for External Debt

The Local Government Act 2003 requires the Authority to set an Affordable Borrowing Limit, irrespective of their indebted status. This is a statutory limit which should not be breached, unless Council authorises an increase to this limit.

The Operational Boundary is based on the same estimates as the Authorised Limit but reflects the most likely, prudent but not worst case scenario without the additional headroom included within the Authorised Limit.

The Authority confirms that there were no breaches to the Authorised Limit and the Operational Boundary during 2014/15 at the end of the financial year:

	Authorised Limit 2014/15 £000s	Operational Boundary 2014/15 £000s	**Actual External Debt** as at 31/03/2015 £000s
Borrowing	260,000	240,000	190,400
Other Long-term Liabilities	51,000	51,000	51,160
Total	**311,000**	**291,000**	**241,560**