

REPORT TO: Audit and Governance Committee

MEETING DATE: 15 July 2014

BY: Depute Chief Executive (Resources & People Services)

SUBJECT: Annual Treasury Management Review 2013/14

1 PURPOSE

- 1.1 To update the Committee on Treasury Management activity during 2013/14

2 RECOMMENDATIONS

- 2.1 Members are asked to note the contents of this report.

3 BACKGROUND

- 3.1 The Council is required by regulations issued under the Local Government Scotland Act 2003 to produce an annual treasury management review.
- 3.2 The attached review updates members on treasury management activity during 2013/14.

4 POLICY IMPLICATIONS

- 4.1 There are no direct policy implications associated with this report however the Council's treasury management activity is determined by the policy framework set out in the approved Treasury Management Strategy.

5 EQUALITIES IMPACT ASSESSMENT

- 5.1 This report is not applicable to the well being of equalities groups and an Equalities Impact Assessment is not required.

6 RESOURCE IMPLICATIONS

- 6.1 Financial – There are no direct financial implications associated with this report however the Council's Treasury Management activity clearly has a significant impact on the management of the Council's financial resources.
- 6.2 Personnel - None
- 6.3 Other - None

7 BACKGROUND PAPERS

- 7.1 Treasury Management Strategy 2013/14 to 2015/16 – East Lothian Council 26 February 2013.

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**Annual Treasury Management
Review 2013/14 – East Lothian
Council**

Annual Treasury Management Review 2013/14

1. Introduction

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

During 2013/14 the council's Treasury Management activities were supported by the following reports:

- The annual Treasury Strategy which was approved by East Lothian Council on 26th February 2013
- A 2013/14 Mid-Year review which was presented to Audit & Governance Committee on 19th November 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 unaudited outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members.

As part of its Treasury Management activity, the Council takes advice from Capita Asset Services (formerly Sector). Capita have provided the economic information and commentary in this review.

2. The Economy and Interest Rates

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. In recent weeks there has been much commentary regarding Bank Rate and Capita's latest advice remains that it will start to rise from Q1 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 Bank Rate ended the year unchanged at 0.5% for the fifth successive year. While 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 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. Upcoming stress tests of Eurozone banks could also reveal some areas of concern.

3. Overall Treasury Position as at 31 March 2014

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

TABLE 1	31 March 2013	31 March 2014
	Principal	Principal
	£m	£m
Total debt:		
PWLB/Market loans	315	339
PPP/Finance Leases	<u>46</u>	<u>45</u>
	361	384
CFR	412	427
Over / (under) borrowing	(51)	(43)
Total investments	0	0
Net debt	361	384

4. The Strategy for 2013/14

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 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, ELC's strategy was to postpone borrowing to avoid the cost of holding higher levels of investments and to reduce counterparty risk. When borrowing was required for cash flow purposes, advantage was taken of cheap short term borrowing from other public bodies.

The actual movement in gilt yields meant that PWLB rates were on a sharply rising trend during 2013 as markets anticipated the start of tapering of asset purchases by the Fed. This duly started in December 2013 and the US FOMC (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.

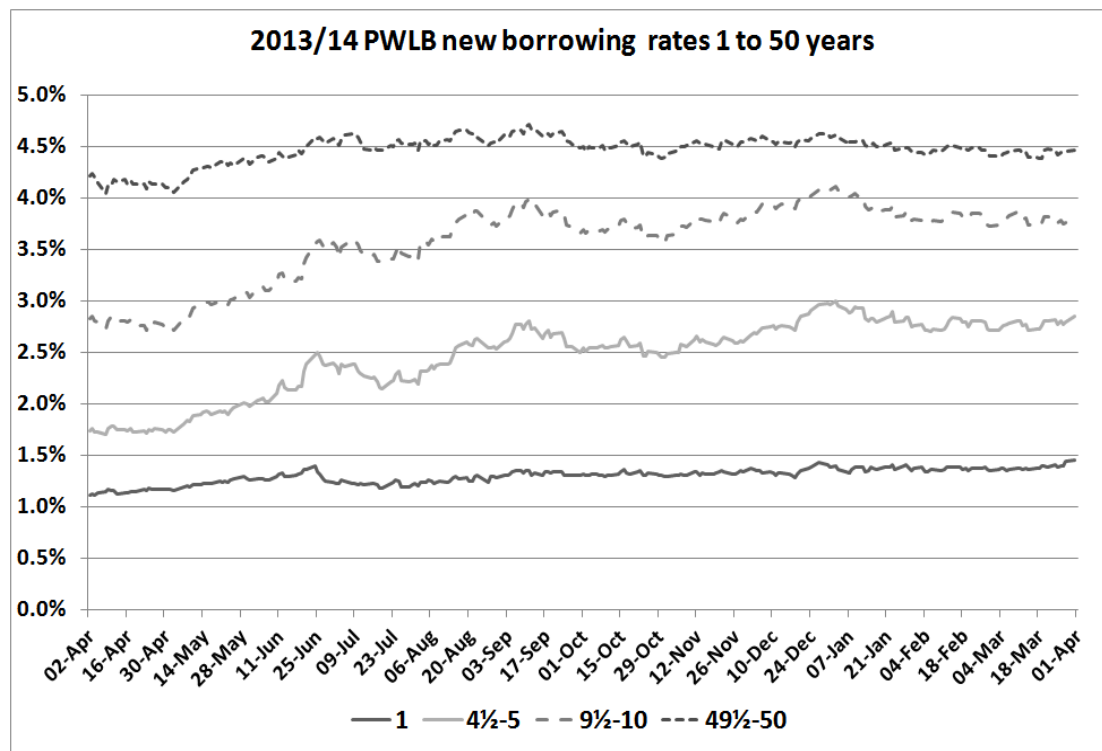
5. The Borrowing Requirement and Debt

The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).

	31 March 2013 Actual £'000	31 March 2014 Budget £'000	31 March 2014 Unaudited Actual £'000
CFR General Fund (£m)	288,430	298,607	291,379
CFR HRA (£m)	123,597	145,802	135,914
Total CFR	412,027	444,409	427,293

6. Borrowing Rates in 2013/14

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



7. Borrowing Outturn for 2013/14

PWLB Borrowing – the following new PWLB fixed interest rate loans were taken during the year:

Date of borrowing	Principal	Maturity	Interest rate
24 April 2013	£1m	49 years	3.96%
24 April 2013	£2m	19 years	3.60%
31 October 2013	£5m	16 years	3.94%
31 October 2013	£5m	17 years	3.99%
Total	£13m		

PWLB Repayment – the following PWLB fixed interest rate loans matured and were repaid:

Date of borrowing	Principal	Maturity	Interest rate
8 Dec 2008	£10m	5 years	3.09%
1 April 1986	£1.5m	28 years	9.125%
14 March 1986	£0.2m	28 years	9.5%
Total	£11.7m		

Temporary borrowing – the following temporary loans were taken from other local authorities during 2013/14:

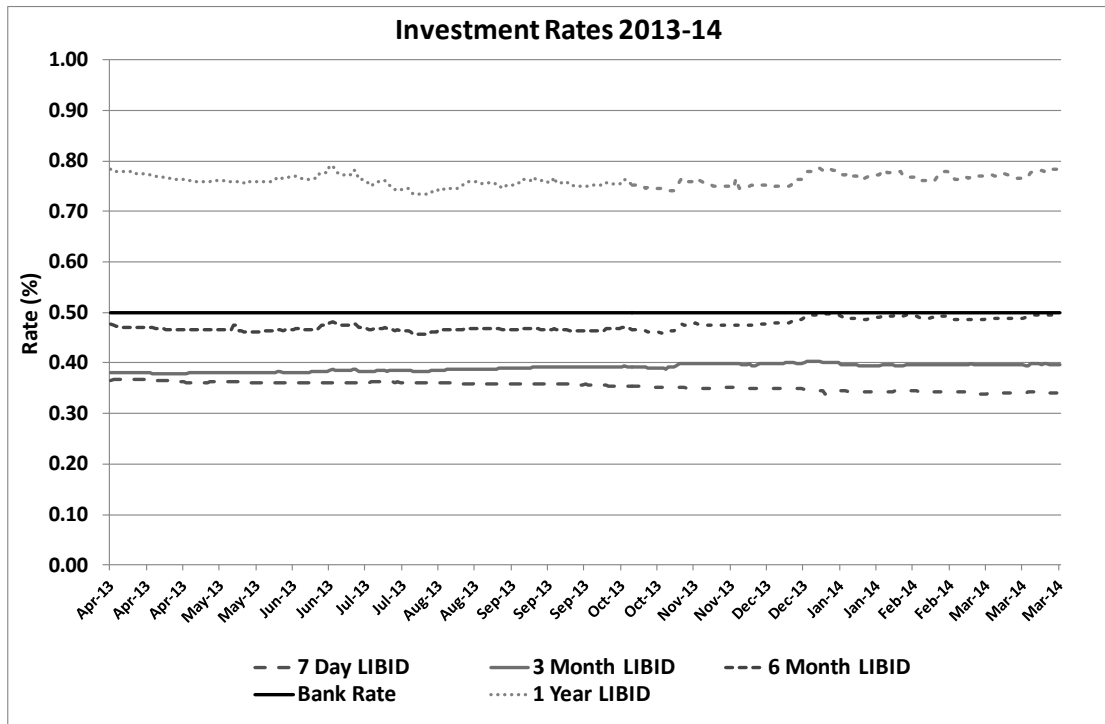
Date of borrowing	Lender	Principal	Interest rate	Date repaid
5 August 2013	Derbyshire CC	£5m	0.4%	5 February 2014
5 August 2013	Worcestershire CC	£5m	0.3%	5 November 2013
5 August 2013	Merseyside ITA	£5m	0.4%	5 February 2014
24 Sept 2013	City of Edinburgh	£10m	0.5%	24 December 2014
30 Sept 2013	Kensington & Chelsea	£5m	0.38%	28 Feb 2014
9 Oct 2013	Leicestershire CC	£2m	0.47%	9 April 2014
15 Oct 2013	Derbyshire CC	£5m	0.47%	15 April 2014
16 Dec 2013	Kensington & Chelsea	£5m	0.47%	30 April 2014
20 Dec 2013	Devon & Cornwall Police	£3m	0.48%	30 April 2014
22 Jan 2014	Hackney	£3m	0.45%	22 April 2014
5 Feb 2014	Merseyside ITA	£5m	0.45%	5 Aug 2014
24 Feb 2014	Redcar & Cleveland	£1m	0.42%	24 June 2014
28 Feb 2014	Kensington & Chelsea	£5m	0.41%	30 June 2014
10 March 2014	Derbyshire CC	£5m	0.45%	10 Sept 2014
31 March 2014	Hertfordshire Police	£5m	0.45%	30 Sept 2014
	Total	£69m		

The following loans taken out in 2012/13 were repaid during 2013/14

Date of borrowing	Lender	Principal	Interest rate	Date repaid
30 Oct 2012	Ealing	£2m	0.4%	30 July 2013
1 Nov 2012	Oxfordshire CC	£5m	0.5%	24 Oct 2013
14 Dec 2012	Surrey Heath BC	£1.5m	0.4%	14 June 2013
22 Jan 2013	Swansea City & County	£3m	0.32%	22 April 2013
28 Jan 2013	Northumberland CC	£2m	0.32%	29 April 2013
	Total	£13.5m		

8. Investment Rates in 2013/14

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.



9. Investment Outturn for 2013/14

Investment Policy – the Council's investment policy is governed by Scottish Government investment regulations, which have been implemented in the annual investment strategy approved by the Council on 26th February 2013. 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.).

The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

Investments held by the Council - the Council did not hold any internally managed investment funds during 2013/14. It did however have the following loans to third parties which fall within the scope of the Council's approved Investment strategy:

Loan	Balance at 31/3/14
East Lothian Housing Association	£5.333m
East Lothian Investments	£0.168m
Musselburgh Old Course Golf Club	£0.047m
Haddington Golf Club	£0.009m

Investments held by fund managers – the Council uses Investec external fund managers to invest cash balances held on behalf of the 4 Common Good funds and ELC Charitable Trusts. The performance of the fund against the benchmark return was:

Fund	Value of Investments Held @ 31/3/13	Value of Investments Held @ 31/3/14	Return	Benchmark
Common Good funds	£2.685m	£2.827m	8.9%	6.7%
Charitable Trusts	£2.637m	£2.767m	8.6%	7.2 %
Total	£5.322m	£5.594m		

Appendix 1: Prudential and treasury indicators

1. PRUDENTIAL INDICATORS	2012/13	2013/14	2013/14
Extract from budget and rent setting report	Actual	Estimate	Unaudited Actual
	£'000	£'000	£'000
Capital Expenditure			
General Services	£28,526	£28,446	£24,825
HRA	£23,690	£25,630	£20,805
TOTAL	£52,216	£54,076	£45,630
Ratio of financing costs to net revenue stream			
General Services	7.73%	8.84%	8.34%
HRA	26.58%	32.05%	26.98%
Net borrowing requirement General Fund			
brought forward 1 April	£282,112	£291,826	£288,430
carried forward 31 March	£288,430	£298,607	£291,379
in year borrowing requirement	£ 6,318	£ 6,781	£ 2,949
Net borrowing requirement HRA (where relevant)			
brought forward 1 April	£106,827	£129,126	£123,597
carried forward 31 March	£123,597	£145,802	£135,914
in year borrowing requirement	£ 16,770	£ 16,676	£ 12,317
Annual change in Cap. Financing Requirement			
Non – HRA	£6,318	£6,781	£ 2,949
HRA (applies only to housing authorities)	£16,770	£16,676	£12,317
TOTAL	£23,088	£23,457	£15,266
Incremental impact of capital investment decisions	£	£	£
Increase in council tax (band D) per annum	£37.66	£36.01	£25.33
Increase in average housing rent per week (housing authorities only)	£2.27	£2.75	£0.91
2. TREASURY MANAGEMENT INDICATORS	2012/13	2013/14	2013/14
	Actual	Estimate	Unaudited Actual
	£'000	£'000	£'000
Authorised Limit for external debt -			
borrowing	£450,000	£427,000	£427,000
other long term liabilities	£ 55,000	£ 57,000	£ 57,000
TOTAL	£505,000	£484,000	£484,000
Operational Boundary for external debt -			
borrowing	£420,195	£397,003	£397,003
other long term liabilities	£ 44,697	£ 47,406	£47,406

TOTAL	£464,892	£444,409	£444,409
External debt	£361,251	£390,667	£384,049

Appendix 2: Graphs

