East Lothian Council

**REPORT TO:** Audit and Governance Committee

**MEETING DATE:** 23 June 2015

**BY:** Depute Chief Executive (Resources and People Services)

**SUBJECT:** Annual Treasury Management Review 2014/15

---

## 1 PURPOSE

1.1 To update the Committee on Treasury Management activity during 2014/15.

## 2 RECOMMENDATIONS

2.1 Members are asked to note the 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 2014/15.

## 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 2014/15 to 2016/17 – East Lothian Council 24th February 2014.

| | |
|---|---|
| **AUTHOR’S NAME** | Liz Shaw |
| **DESIGNATION** | Service Manager - Corporate Finance |
| **CONTACT INFO** | lshaw@eastlothian.gov.uk |
| **DATE** | 18/06/15 |

# **Annual Treasury Management Review**
2014/15 – East Lothian Council

# Annual Treasury Management Review 2014/15

## 1. Introduction

East Lothian 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 2014/15. 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 2014/15 the minimum reporting requirements were that the full Council should receive the following reports:

- an annual treasury strategy in advance of the year (approved by Council 25/02/2014)
- a mid-year (minimum) treasury update report (presented to Audit and Governance Committee 18/11/2014)
- 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 Council's policies previously approved by members.

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

## 2. The Economy and Interest Rates

The original market expectation at the beginning of 2014/15 was for the first increase in Bank Rate to occur in quarter 1 2015 as the unemployment rate had fallen much faster than expected through the Bank of England's initial forward guidance target of 7%. In May, however, the Bank revised its forward guidance. A combination of very weak pay rises and inflation above the rate of pay rises meant that consumer disposable income was still being eroded and in August the Bank halved its forecast for pay inflation in 2014 from 2.5% to 1.25%. Expectations for the first increase in Bank Rate therefore started to recede as growth was still heavily dependent on buoyant consumer demand. During the second half of 2014 financial markets were caught out by a halving of the oil price and the collapse of the peg between the Swiss franc and the euro. Fears also increased considerably that the ECB was going to do too little too late to ward off the threat of deflation and recession in the Eurozone. In mid-October, financial markets had a major panic for about a week. By the end of 2014, it was clear that inflation in the UK was going to head towards zero in 2015 and possibly even turn negative. In turn, this made it clear that the MPC would have great difficulty in starting to raise Bank Rate in 2015 while inflation was around zero and so market expectations for the first increase receded back to around quarter 3 of 2016.

Gilt yields were on a falling trend for much of the last eight months of 2014/15 but were then pulled in different directions by increasing fears after the anti-austerity parties won power in Greece in January; developments since then have increased fears that Greece could be heading for an exit from the euro. While the direct effects of this would be manageable by the EU and ECB, it is very hard to quantify quite what the potential knock on effects would be on other countries in the Eurozone once the so called impossibility of a country leaving the EZ had been disproved. Another downward pressure on gilt yields was the announcement in January that the ECB would start a major programme of quantitative easing, purchasing EZ government and other debt in March. On the other hand, strong growth in the US caused an increase in confidence that the US was well on the way to making a full recovery from the financial crash and would be the first country to start increasing its central rate, probably by the end of 2015. The UK would be closely following it due to strong growth over both 2013 and 2014 and good prospects for a continuation into 2015 and beyond. However, there was also an increase in concerns around political risk from the general election due in May 2015.

## 3. Overall Treasury Position as at 31 March 2015

At the beginning and the end of 2014/15 the Council's treasury position was as follows:

| TABLE 1 | 31 March 2014 Principal | 31 March 2015 Principal |
|---|---|---|
| | £m | £m |
| **Total debt:** | | |
| **PWLB/Market loans** | **339** | **335** |
| **PPP/Finance Leases** | **45** | **44** |
| | **384** | **379** |
| **CFR** | **407** | **416** |
| **Over / (under) borrowing** | **(23)** | **(37)** |
| **Total investments** | **0** | **0** |
| **Net debt** | **384** | **379** |

## 4. The Strategy for 2014/15

The expectation for interest rates within the strategy for 2014/15 anticipated low but rising Bank Rate (starting in quarter 1 of 2015), and gradual rises in medium and longer term fixed borrowing rates during 2014/15. 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 to avoid the cost of holding higher levels of investments and to reduce counterparty risk.

The actual movement in gilt yields meant that PWLB rates saw little overall change during the first four months of the year but there was then a downward trend for the rest of the year with a partial reversal during February.

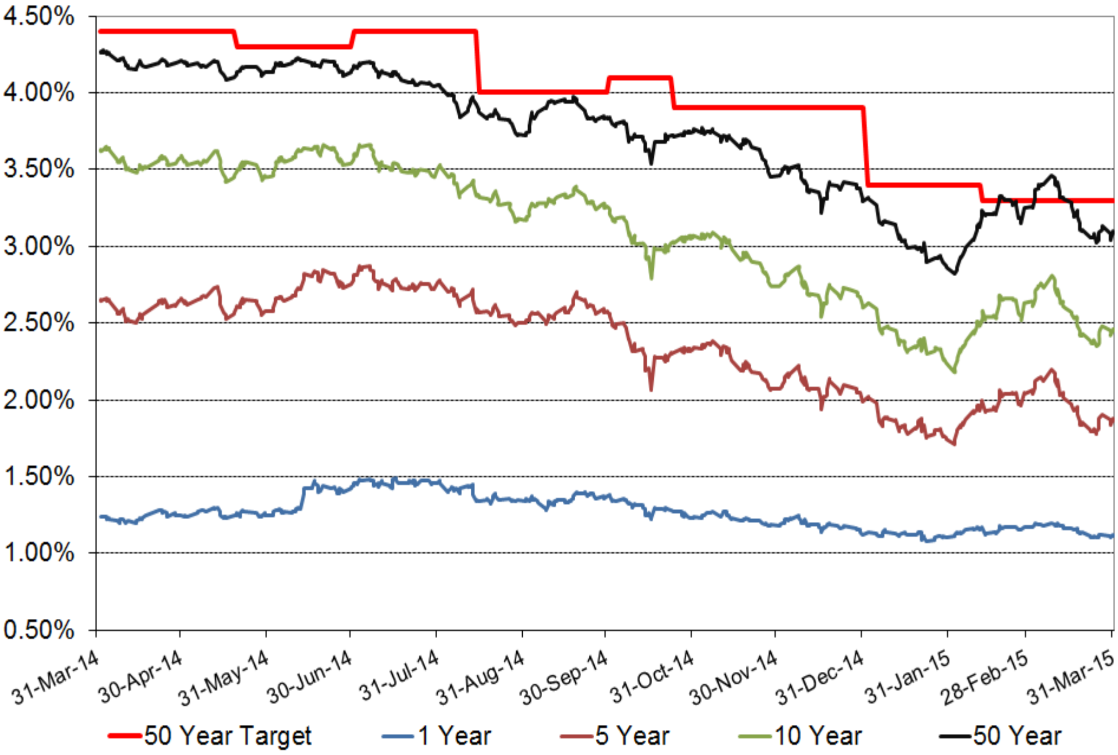
# 5. The Borrowing Requirement and Debt

The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR). The General Fund CFR outturn saw a reduction against forecast of £2m. This comprises a reduction of £3M of General Fund capital spend off-set by a £2m reduction in capital receipts and revenue contributions and a £1m reduction in the estimated long term liability payment. The HRA CFR has increased by £4M and is attributable to a £5m reduction in HRA capital grants off-set by a reduction in HRA capital spend of £1m. The total CFR has risen year on year by £9M against the forecast of £6M.

| | 31 March 2014 Actual | 31 March 2015 Budget | 31 March 2015 Actual |
|---|---|---|---|
| CFR General Fund (£m) | 267 | 268 | 266 |
| CFR HRA (£m) | 140 | 145 | 149 |
| Total CFR | 407 | 413 | 416 |

## 6. Borrowing Rates in 2014/15

**PWLB borrowing rates -** the graph below shows how PWLB certainty rates have fallen to historically very low levels during the year.




## 7. Borrowing Outturn for 2014/15

**PWLB Borrowing** – the following new PWLB loans were taken during the year: -

| Date of borrowing | Principal | Maturity | Interest rate |
|---|---|---|---|
| 26 September 2014 | £5m | 50 Years | 3.82% |
| 8 October 2014 | £5m | 46 years | 3.70% |
| 8 October 2014 | £5m | 47 years | 3.70% |
| 16 December 2014 | £10m | 49 years | 3.35% |
| 10 March 2015 | £7.5m | 19 years | 3.28% |
| 10 March 2015 | £7.5m | 20 years | 3.32% |
| Total | £40m | | |

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

| Date of borrowing | Principal | Maturity | Interest rate |
|---|---|---|---|
| 1 April 1986 | £0.7m | 29 years | 9.125% |
| 30 April 2009 | £5m | 5 years | 2.84% |
| | | | |
| Total | £5.7m | | |

**Temporary borrowing** – the following temporary loans were taken from other local authorities during 2013/14 and repaid in 2014/15

| Date of borrowing | Lender | Principal | Interest rate | Date repaid |
|---|---|---|---|---|
| 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 August 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 | £39m | | |

The following loans taken out in 2014/15 and were repaid

| Date of borrowing | Lender | Principal | Interest rate | Date repaid |
|---|---|---|---|---|
| 17 April 2014 | Leicestershire CC | £10m | 0.4% | 17 Oct 2014 |
| 29 April 2014 | Derbyshire CC | £5m | 0.4% | 24 Oct 2014 |
| 24 Sept 2014 | Leicestershire CC | £10 | 0.5% | 19 Dec 2014 |
| 4 Dec 2014 | C&C of Swansea | £3m | 0.5% | 19 Dec 2014 |
| 17 Dec 2014 | Middlesbrough | £4m | 0.42% | 7 Jan 2015 |
| 19 Dec 2014 | Leicester CC | £2m | 0.5% | 7 Jan 2015 |
| 26 Jan 2015 | Worcestershire CC | £1m | 0.3% | 28 Jan 2015 |
| 10 Sept 2014 | Derbyshire CC | £5m | 0.5% | 10 March 2015 |
| | Total | £40m | | |

The following was taken out in 2014/15 and is due to be repaid in 2015/16

| Date of borrowing | Lender | Principal | Interest rate | Date repaid |
|---|---|---|---|---|
| 30 Sept 2014 | Northamptonshire | £3m | 0.7% | 30 Sept 2015 |

Due to lower than estimated levels of long term borrowing the actual financing costs for both HRA and General fund were lower than budgeted. As can be seen above a significant amount of the required funding was done through temporary borrowing, thereby funding at rates lower than budgeted rates. This is then reflected in the incremental impact of capital investment decisions represented by the notional increase in council tax per annum and the notional increase in average housing rents per week (Appendix 1)

**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.

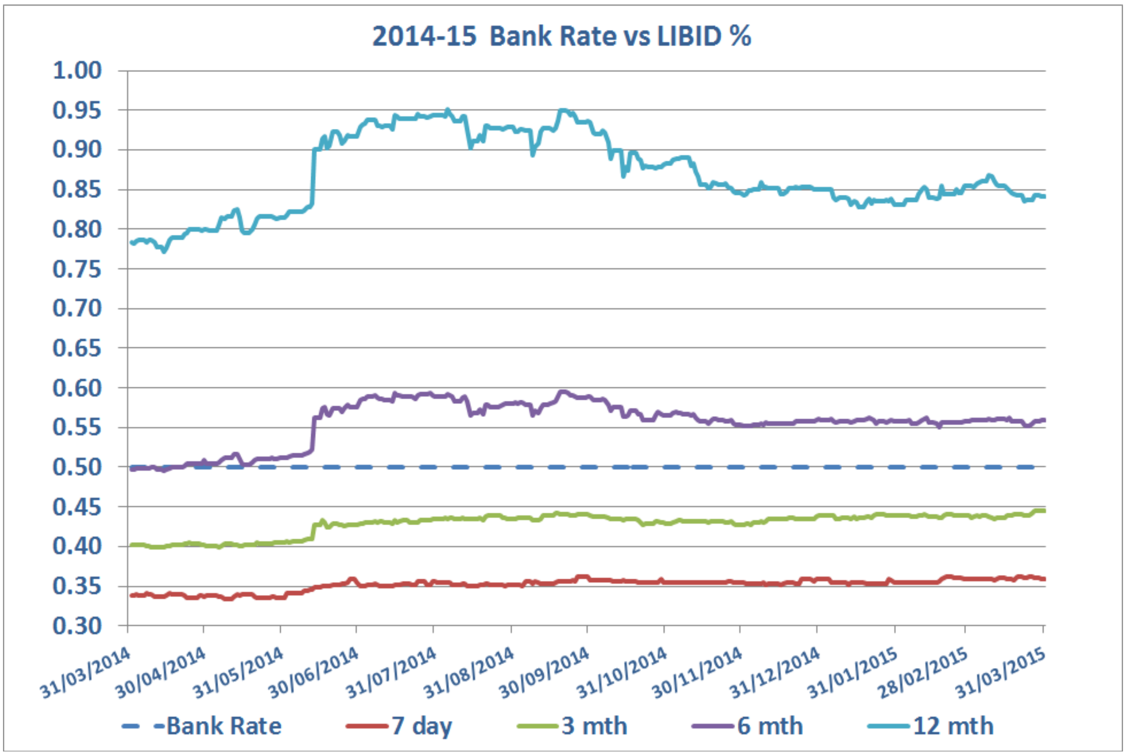
**Compliance with Treasury and Prudential Limits**

It is a statutory duty for the Council to determine and keep under review the affordable capital expenditure limits. The Council's Treasury and Prudential indicators (affordability limits) are included in the approved Treasury Management Strategy statement.

During the year the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices. The prudential and treasury indicators are shown in appendix 1.

# 8. Investment Rates in 2014/15

Bank Rate remained at its historic low of 0.5% throughout the year; it has now remained unchanged for six years. Market expectations as to the timing of the start of monetary tightening started the year at quarter 1 2015 but then moved back to around quarter 3 2016 by the end of the year. Deposit rates remained depressed during the whole of the year, primarily due to the effects of the Funding for Lending Scheme.



# 9. Investment Outturn for 2014/15

.

**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 25/02/2014. 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.).

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 had minimal investment balances during the year as it sought to minimise its debt costs i.e. the Council temporarily used its reserves instead of external borrowing during 2014/15. 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 31/3/15 |
|---|---|
| East Lothian Housing Association | £6.364m |
| East Lothian Investments | £0.048m |
| Haddington Golf Club | £0.005m |

**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 @ 31/03/14 | Value of Investments Held @ 31/03/15 | Return | Benchmark |
|---|---|---|---|---|
| Common Good funds | £2.827m | £3.053m | 11.6% | 11.2% |
| Charitable Trusts | £2.767m | £2.985m | 11.6% | 12.6% |
| Total | £5.954m | £6.038m | | |

The return on the charitable trusts investment was 11.6% which was 1% less than the Benchmark figure. The reason for this is that other Charities within the benchmarking group invested more in the US market during the 2014/15 financial year achieving a greater return. The other reason for the difference in our return from the Benchmark is that we continue to invest in short-dated bonds rather than long-dated and although long-dated bonds have performed better to date it is anticipated that the performance of long dated bonds will be poor going forward and we will benefit in the longer term.

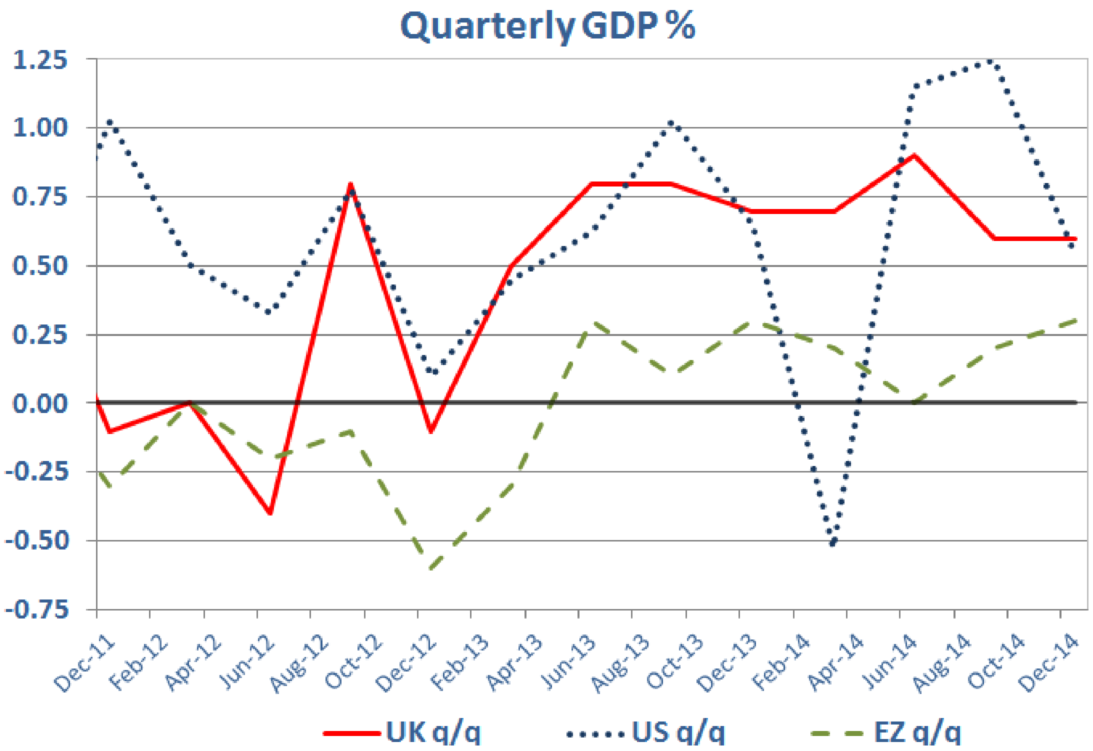
# Appendix 1: Prudential and treasury indicators

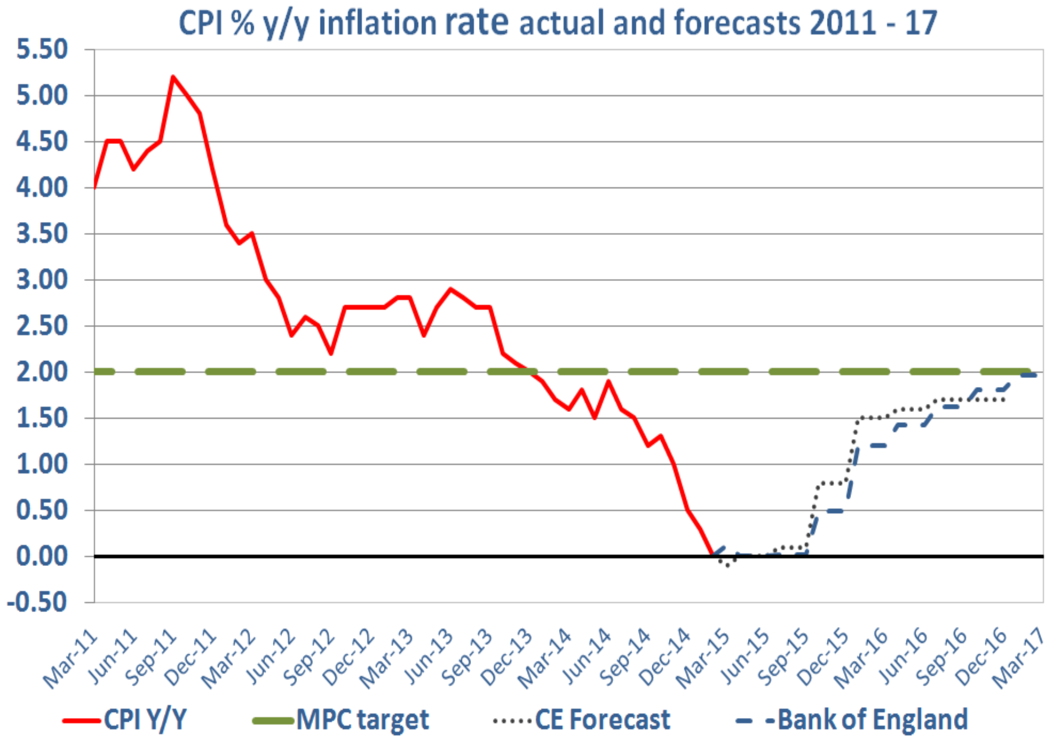
| 1. PRUDENTIAL INDICATORS | 2013/14 | 2014/15 | 2014/15 |
|---|---|---|---|
| | actual | original | actual |
| | £'000 | £'000 | £'000 |
| **Capital Expenditure** | | | |
| Non - HRA | £24,825 | £21,510 | £18,391 |
| HRA | £20,805 | £22,184 | £20,798 |
| TOTAL | £45,630 | £43,694 | £39,189 |
| **Ratio of financing costs to net revenue stream** | | | |
| Non - HRA | 8.34% | 8.58% | 8.19% |
| HRA | 26.98% | 34.14% | 30.63% |
| **Gross borrowing requirement General Fund** | | | |
| brought forward 1 April | £268,328 | £267,161 | £267,161 |
| carried forward 31 March | £267,161 | £268,642 | £266,481 |
| in year borrowing requirement | £1,167 | (£1,481) | (£680) |
| **Gross borrowing requirement HRA** | | | |
| brought forward 1 April | £123,597 | £140,378 | £140,378 |
| carried forward 31 March | £140,378 | £145,358 | £148.804 |
| in year borrowing requirement | £16,781 | £4,980 | £8,426 |
| **Gross debt** | £407,539 | £414,000 | £415,825 |
| **CFR** | | | |
| Non – HRA | £267,161 | £268,642 | £266,481 |
| HRA | £140,378 | £145,358 | £148 ,804 |
| TOTAL | £407,539 | £414,000 | £415,825 |
| **Annual change in Cap. Financing Requirement** | | | |
| Non – HRA | £1,167 | (£1,481) | (£680) |
| HRA | £16,781 | £4,980 | £8,426 |
| TOTAL | £18,111 | £4,892 | £7,569 |
| **Incremental impact of capital investment decisions** | **£ p** | **£ p** | **£ p** |
| Notional increase in council tax (band D) per annum | £25.33 | £18.64 | £3.14 |
| Notional increase in average housing rent per week | £0.91 | £4.61 | £2.61 |

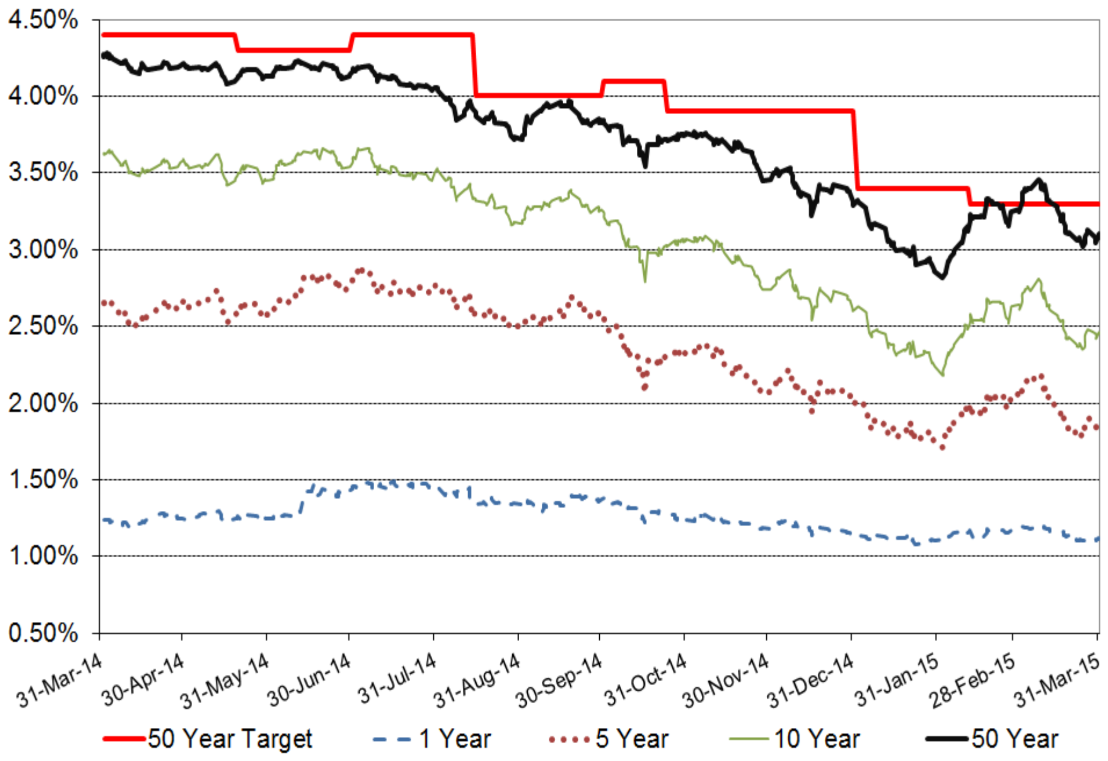
| 2. TREASURY MANAGEMENT INDICATORS | 2013/14 | 2014/15 | 2014/15 |
|---|---|---|---|
| | actual | original | actual |
| | £'000 | £'000 | £'000 |
| **Authorised Limit for external debt -** | | | |
| borrowing | £ 427,000 | £433,000 | £433,000 |
| other long term liabilities | £ 57,000 | £55,000 | £55,000 |
| TOTAL | £ 484,000 | £488,000 | £488,000 |
| **Operational Boundary for external debt -** | | | |
| borrowing | £ 397,003 | £403,259 | £403,259 |
| other long term liabilities | £ 47,406 | £44,763 | £44,763 |
| TOTAL | £ 444,409 | £448,022 | £488,022 |
| **Actual external debt** | £ 384,049 | £370,121 | £378,425 |
| **Upper limit for fixed interest rate exposure** | | | |
| Net interest re fixed rate borrowing / investments | 100% | 100 % | 100 % |
| **Upper limit for variable rate exposure** | | | |
| Net interest re variable rate borrowing / investments | 30% | 30 % | 30 % |
| **Upper limit for total principal sums invested for over 364 days** | £30m | £30m | £30m |

| Maturity structure of fixed rate borrowing during 2014/15 | upper limit | lower limit |
|---|---|---|
| under 12 months | 20% | 0% |
| 12 months and within 24 months | 30% | 0% |
| 24 months and within 5 years | 40% | 0% |
| 5 years and within 10 years | 40% | 0% |
| 10 years and above | 75% | 0% |

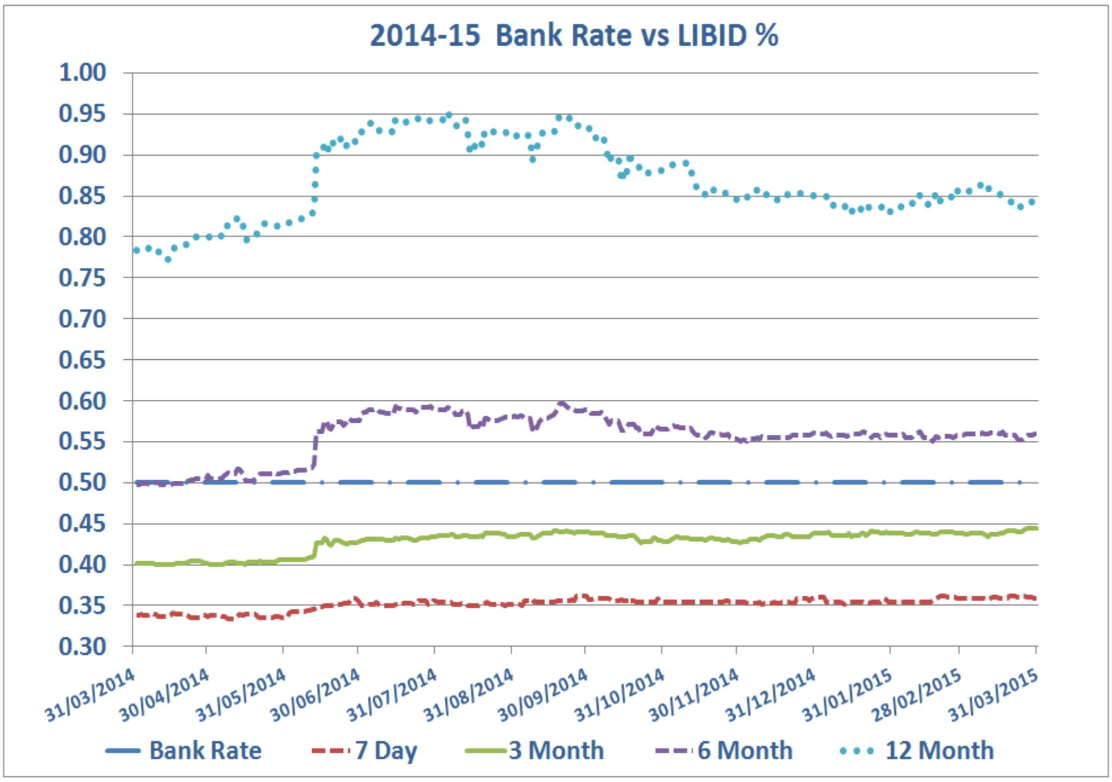
# Appendix 2: Graphs





4.50%
4.00%
3.50%
3.00%
2.50%
2.00%
1.50%
1.00%
0.50%
31-Mar-14
30-Apr-14
31-May-14
30-Jun-14
31-Jul-14
31-Aug-14
30-Sep-14
31-Oct-14
30-Nov-14
31-Dec-14
31-Jan-15
28-Feb-15
31-Mar-15
50 Year Target
1 Year
5 Year
10 Year
50 Year

2014-15 Bank Rate vs LIBID %
1.00
0.95
0.90
0.85
0.80
0.75
0.70
0.65
0.60
0.55
0.50
0.45
0.40
0.35
0.30
31/03/2014
30/04/2014
31/05/2014
30/06/2014
31/07/2014
31/08/2014
30/09/2014
31/10/2014
30/11/2014
31/12/2014
31/01/2015
28/02/2015
31/03/2015
Bank Rate
7 Day
3 Month
6 Month
12 Month