

# Housing, Finance and Customer Services Policy and Scrutiny Committee

<b>Date:</b>	<b>27<sup>th</sup> April 2015</b>
<b>Classification:</b>	<b>General Release</b>
<b>Title:</b>	<b>Treasury Outturn Report</b>
<b>Report of:</b>	<b>City Treasurer</b>
<b>Cabinet Member Portfolio:</b>	<b>Cabinet Member for Finance and Customer Services</b>
<b>Wards Involved:</b>	<b>All</b>
<b>Policy Context:</b>	<b>The efficient management of the Council's financial affairs</b>
<b>Financial Summary:</b>	<b>Treasury management continues to operate in a challenging environment.</b>
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## 1. EXECUTIVE SUMMARY

- 1.1. This report presents the Council's Annual Treasury Outturn Report for 2014/15 in accordance with the Council's treasury management practices. It is a regulatory requirement for this outturn report to be presented to Council by 30 September each year.
- 1.2. The Local Government Act 2003 (the Act) and related regulations issued by the Secretary of State require the production of an annual treasury report following year-end setting out the activities undertaken during the year. As well as the Act and relevant regulations, authorities are also required to have regard to guidance issued by the Secretary of State and the Chartered Institute of Public Finance and Accountancy (CIPFA); namely:
  - Guidance on Local Government Investments
  - Guidance on Minimum Revenue Provision
  - CIPFA Code of Practice on Treasury Management in the Public Services

- CIPFA Prudential Code for Capital Finance

This report meets the requirements set out in the above guidance.

1.3. The Act also requires Authorities to determine an affordable borrowing limit for the year, which cannot be breached. This report confirms that borrowing remained well within the limit set prior to the start of the financial year.

1.4. There are two aspects of Treasury performance – debt management and cash investments. Debt management relates to the City Council’s borrowing and cash investments to the investment of surplus cash balances. This report covers:

- Investment activity during 2014/15
- Borrowing activity during 2014/15
- the capital expenditure and financing for 2014/15;
- the UK economy and interest rates
- compliance with treasury limits and prudential indicators
- way forward for treasury in 15/16

1.5. The key Prudential Indicators and treasury position is set out as follows:

Prudential Indicator	2013/14 Actual £m	2014/15 Indicator £m	2014/15 Actual £m
<b>Capital Expenditure</b>	<b>105</b>	<b>189</b>	<b>184</b>
<b>Capital Financing Requirement</b>			
General Fund	107	115	165
Housing Revenue Account	276	276	276
<b>Total</b>	<b>383</b>	<b>391</b>	<b>441</b>
Total borrowing	285		283
Total investments	628		605
<b>Total Net</b>	<b>343</b>		<b>322</b>

1.6 Capital Expenditure was slightly below the estimate for the year mainly as a result of slippage. The Capital Financing Requirement (CFR) was higher than expected as a result of changes in the calculation methodology implemented during 2014/15. The net surplus for the authority moved down from £343m to £322m over the year; this cash outflow of £21m was predominantly as a result of capital expenditure financed from Prudential Borrowing, off-set by positive reserve movements and working capital. This was reflected in the reduction in investment balances. Borrowings remained broadly unchanged over the year, with a small reduction as principal was repaid.

## 2. KEY MATTERS FOR THE COMMITTEE’S CONSIDERATION

The Committee is asked to note this report.

### 3. BACKGROUND

3.1. The Council has fully adopted the recommendations in CIPFA's Code of Practice on Treasury Management in the Public Services. Specifically this includes:

- Creation of a Treasury Management Policy Statement
- Development and maintenance of Treasury Management Practices setting out how the treasury objectives will be met
- Production of reports to Council including annual strategy in advance of the start of the year, a mid-year review and an annual review following the year-end
- Delegation to City Treasurer of the responsibility for implementation and monitoring the policies and practices as well as the execution and administration of the treasury management decisions

3.2. This report presents the Council's Annual Treasury Report for 2014/15 in accordance with the Council's treasury management practices. This report covers:

- Investment activity during 2014/15
- Borrowing activity during 2014/15
- Capital Expenditure & Financing
- the UK economy and interest rates
- compliance with treasury limits and prudential indicators
- the way forward in 2015/16

### 4. INVESTMENT ACTIVITY DURING 2014/15

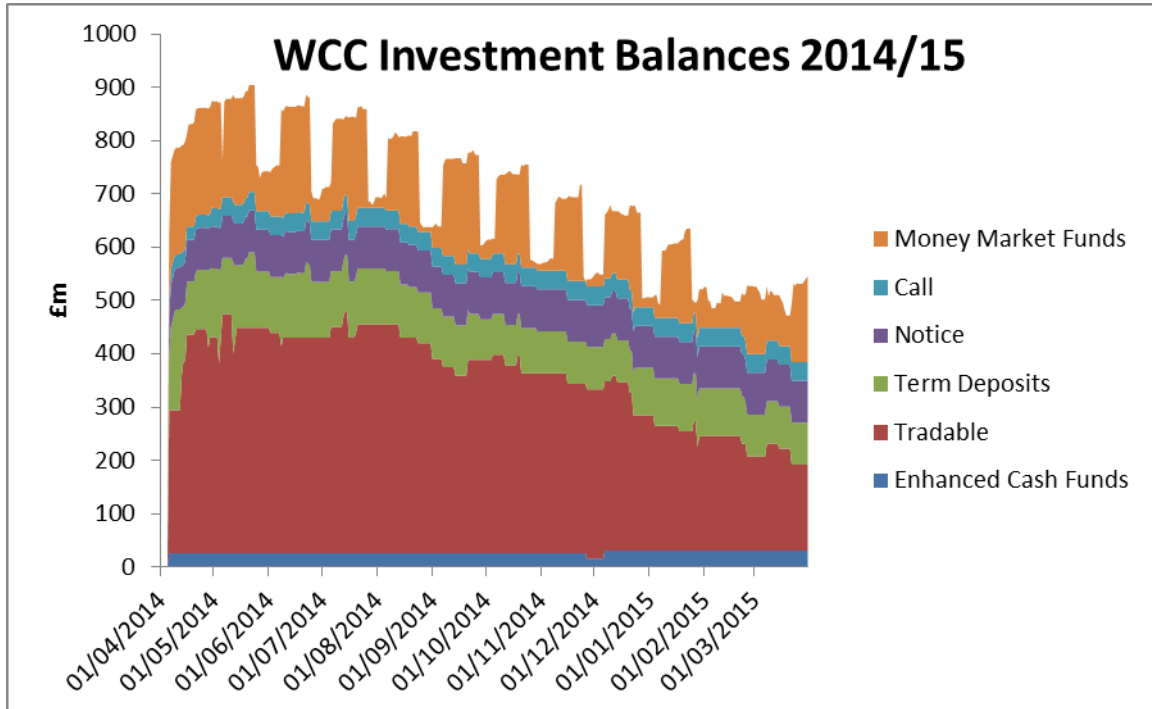
#### Position at 31<sup>st</sup> March 2015

4.1. The table below provides a breakdown of the cash deposits, together with comparisons from the previous year:

<b>Investment Type</b>	<b>Investment balance 31 March 2014 (£m)</b>	<b>Investment balance 31 March 2015 (£m)</b>	<b>Movement (£m)</b>
Money Market Funds	126.00	200.00	74.00
Call Accounts	30.09	35.00	4.91
Notice Accounts	78.56	78.72	0.16
Term Deposits	99.00	109.70	10.7
Tradable Securities	268.01	149.99	(118.02)
Enhanced Cash Funds	26.48	31.32	4.84
<b>Total:</b>	<b>628.14</b>	<b>604.73</b>	<b>(23.41)</b>

## Activity During 2014/15

- 4.2. Total cash balances during 2014/15 varied considerably, predominantly as a result of the significant peaks and troughs arising from the payment profile of Business Rates collection and Rates Retention payments to CLG and GLA. The investment balance therefore ranged between £478m and £904m and averaged £683m.

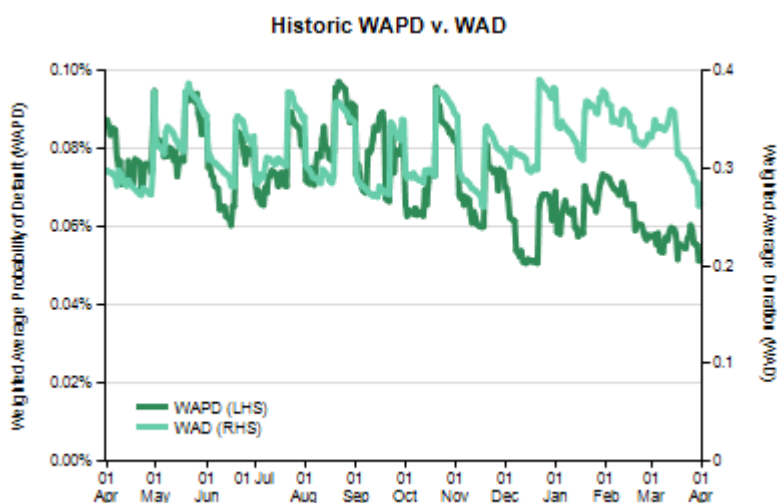


- 4.3. Liquidity was managed through call accounts and money market funds. At year end there was just one call account balance held with a highly rated European bank and a further £200m of liquid balances invested in four money market funds. The funds return 0.40% - 0.55% depending on their investment approach (all are rated AAA by at least one, and in most cases two, rating agencies). The average balance was £119m over the course of the year, and peaked at £218m.
- 4.4. There are two notice accounts utilised, where rates are based on LIBOR plus a margin and notice is required for 65 days and 3 months. The balances have remained relatively static throughout the year, although for one of the accounts interest is added to the balance in the account rather than being repaid to the Council.
- 4.5. The term deposits at year-end comprise seven fixed term bank deals and a deposit with the Debt Management Office. All deposits will be maturing before November 2015. Two of the deposits were entered into in 2010 and were variable, and one had a floor ensuring a minimum rate of 3% was achieved. The remaining deposits are all shorter term fixed rate deals and were raised during 2014/15.

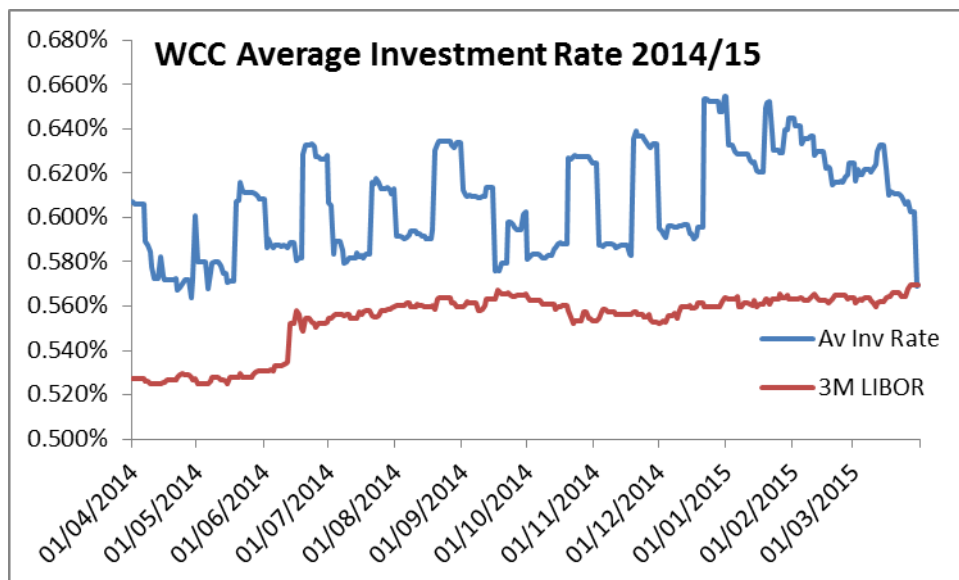
- 4.6. The Council has been reasonably active in tradable securities during the year, comprising commercial paper issued by Transport for London, Network Rail bonds, Supranational Bank bonds, UK Government issued gilts and treasury bills. The vast majority of these securities have been short dated and purchased on the secondary market with a few months remaining until maturity. It is the Council's policy to hold these assets to maturity and has no intention of disposing prior to this. During 14/15 no securities were sold prior to maturity.
- 4.7. As at 31<sup>st</sup> March 2015 the Council had investments in two enhanced cash funds. These funds do not distribute income and instead any gains are accumulated into the unit price. Therefore the returns on the funds are reflected as unrealised gains which only become realised once units are sold. During 2014/15 some units were disposed of in one of the funds, producing a small gain, this was followed by the purchase of further units at a later date thus increasing the value invested in the Enhanced cash funds from £26m to £31m during the year.

### Performance

- 4.8. All investments entered into by the authority during 2014/15 were fully compliant with the Annual Investment Strategy. The strategy makes clear that the investment priorities are given to security of principal then liquidity over yield. To this extent all investments have only been made with counterparties of high credit quality. The chart below quantifies the credit exposure over the year by calculating the weighted average probability of default (WAPD) for each investment entered into over the course of the year and compares to the weighted average duration (WAD) of the portfolio



- 4.9. This chart shows volatility in the duration of the portfolio; generally as a result of the large swings in money market fund balances, which effectively have a zero duration as a result of the instant liquidity. The credit risk of the portfolio has reduced over the course of the year. This is largely down to reduction in the exposure to some UK banks.
- 4.10. The weighted average interest rate of return on the investments over the year was 0.60%, with total interest received of £3.93m. The respective figures for 2013/14 were 0.60% and £3.97m.



4.11 The chart above shows the relative volatility in the rate during the year calculated as a weighted average on a daily basis. Towards the end of the year, the rate dropped off as deposits were placed with the Debt Management Office on a very short term timescale which impacted on the rate being achieved. The rate achieved has been significantly above 3 month LIBOR over the course of the year.

## 5. BORROWING ACTIVITY DURING 2014/15

### Position at 31<sup>st</sup> March 2015

5.1 The Council operates a two-pool approach to the apportionment of its debt, with each revenue account bearing an appropriate proportion of external debt; reflecting the manner in which historic capital has been incurred. The HRA's gross indebtedness is measured by its Capital Financing Requirement and where the actual level of borrowing falls below this level, this is considered as borrowing from the General Fund in order that each revenue account is appropriately charged with the costs of its indebtedness.

5.2 The table below shows the details around the Council's external borrowing (as at 31 March 2015), split between the General Fund and HRA. This is a gross position not taking into account any internal cross lending.

	31/03/2014 Balance £m	31/03/2015 Balance £m	Average Balance £m	Average Rate
General Fund	25.53	26.07	25.86	4.161%
HRA	258.59	257.78	258.08	4.804%
<b>Total</b>	<b>284.12</b>	<b>283.85</b>	<b>283.94</b>	<b>4.745%</b>

- 5.3 The outstanding loans comprise a combination of PWLB and Market loans, with a very small amount of historic mortgages advanced in the 1960s.

#### **Activity During 2014/15**

- 5.4 Total borrowings decreased by £1.3m as loans matured during the year and no new borrowing was undertaken.
- 5.5 Whilst opportunities for debt restructuring / repayment continued to be monitored, it was not considered that it was an appropriate opportunity at this stage to pursue this strategy as discount rates were deemed to be very low, and consequently premia considered high.

#### **Performance**

- 5.6 The portfolio average rate remained reasonably stable throughout the year, starting at 4.757%, and ending the year at 4.737%. This reduction was as a result of the small value of high coupon loans maturing.

	<b>Average Balance £m</b>	<b>Average Rate</b>
PWLB Loans	213.3	4.625%
Market Loans	70.0	5.08%
<b>Total</b>	<b>283.3</b>	<b>4.737%</b>

## **6 CAPITAL EXPENDITURE & FINANCING**

### **Capital Expenditure**

- 6.1 The level and financing decisions of capital spend have a major impact on the treasury management position of the Council. The Council has a number of available sources of financing to apply to capital expenditure and makes decisions based on maximising the available resources.
- 6.2 The Prudential Code requires indicators to be set in respect of the overall level of Capital Expenditure for the General Fund and Housing Revenue Account. The table below sets out the indicator and the sources of financing used to fund this spend:

	<b>2013/14 Actual £m</b>	<b>2014/15 Indicator £m</b>	<b>2014/15 Actual £m</b>
General Fund Capital Expenditure	75	71	76
HRA Capital Expenditure	30	118	108
<b>Total Capital Expenditure</b>	<b>105</b>	<b>188</b>	<b>184</b>
Financed by:			
Capital Receipts	4	8	8
Capital Grants	52	61	58
Revenue	9	42	35
Major Repairs Allowance	17	17	17
Prudential Borrowing	23	61	65

- 6.3 The small underspend on capital resulted in a lower charge to revenue than was anticipated at the time the indicator was determined, and Prudential borrowing was marginally higher than expected.

### **Capital Financing Requirement**

- 6.4 Ultimately all expenditure incurred by the Council has to be resourced in some way. Revenue expenditure must be resourced using revenue sources of finance. Capital expenditure, as shown by the table above, has a number of financing options available. If the Council is able to receive a grant for certain schemes, or charge to a revenue account, by way of example, this has the impact of immediately resourcing that expenditure. However, if these sources are not available, or sufficient to meet the extent of the planned expenditure, then Prudential Borrowing can be undertaken which defers the total resourcing. The amount of historic capital expenditure which has yet to be resourced is measured by the Capital Financing Requirement (CFR).
- 6.5 Ultimately this resourcing will take place through the Minimum Revenue Provision (MRP) mechanism which requires authorities to make an annual charge to the revenue account over the lifetime of the assets being financed in this way. Guidance issued by the Secretary of State set out recommendations for authorities to follow when determining this provision. The guidance requires authorities to produce an annual MRP policy in advance of the start of the year. The policy for 2014/15 was included within the Treasury Management Strategy report approved by Council in February 2014. So the CFR increases each year by the value of capital expenditure met by Prudential Borrowing, and reduces as MRP resources this spend on an annual basis.
- 6.6 In addition to MRP which reduces the underlying need to borrow over time, authorities can also make additional MRP charges to revenue known as Voluntary MRP or apply capital receipts up to the value of any debt that has been repaid.
- 6.7 Another component of the CFR is the element relating to other long term liabilities; specifically finance leases and PFI contracts. This element of the CFR is written down each year by the principal elements of the lease repayments.
- 6.8 Once of the key Prudential Indicators relates to the CFR and ensuring that gross borrowing does not exceed the CFR. The Prudential Indicator in respect of the CFR is set out below:



	<b>General Fund</b>	<b>Housing Revenue Account</b>	<b>Total</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>
<b>Adjusted Opening CFR 31/03/2014</b>	<b>107.27</b>	<b>276.12</b>	<b>399.10</b>
Prudential Borrowing in 2014/15	65.46	-	65.46
Capital Receipts applied to reduce CFR	(1.53)	-	(1.53)
Minimum Revenue Provision	(4.30)	-	(4.30)
MRP in respect of Other Long Term Liabilities	(2.14)	-	(2.14)
<b>Closing CFR</b>	<b>164.76</b>	<b>276.12</b>	<b>456.59</b>
<b>Prudential Indicator projected closing position 2014/15</b>	<b>114.79</b>	<b>275.87</b>	<b>390.01</b>

6.9 The increase in the General Fund CFR for 2014/15 is predominantly as a result of capital expenditure financed by Prudential Borrowing during the year.

## **7 THE ECONOMY AND INTEREST RATES**

- 7.1 UK growth was robust in the first quarter of the year largely as a result of strong household spending, and confidence reached the highest levels seen since 2005 according to the GfK consumer confidence survey.
- 7.2 GDP posted a 3% annual increase over 2014, and forward looking indicators such as the Purchasing Managers Index were all in positive territory for the year for both Manufacturing and Services. Unemployment continued its fall over the year, dropping from 6.6% in April to 5.5% in February 2015. A large contributor of this growth was consumer spending, which was supported by very strong Consumer Confidence Surveys; the GfK figure for March showed the strongest seen for 13 years.
- 7.3 Oil had an interesting year, initially increasing on Q1 2014/15 as geopolitical risks in the Middle East caused worries over supply. However this was reversed over the following quarter as concerns over growth in China as well as a strengthening dollar exerted downward pressure. Over the rest of 2014 the decline steepened as North American attempts at fracking and extracting from Oil Sands reduced their overall demand from global markets. The decision taken by Saudi Arabia to maintain market share and allow the price to drop was a major contributor. Despite a small recovery in Q1 2015, Oil ended up at approximately half the value it started the year at.
- 7.4 This had a direct bearing on inflation, with CPI reaching a 12 year low in November 2014 of 1%. The decline continued, reaching zero in February and remaining at that level in March.
- 7.5 The market began the year with the expectation that interest rates would be unlikely to be raised until 2015 and, despite strongly positive messages from Governor Carney suggesting rises sooner than the market expects, and that the point at which interest rates begin to normalise was getting closer, the dipping of CPI proved more of a driving force behind the markets, and the consensus at the year-end was for the expectation of the first rate rise to occur in Q3 2016. Longer term rates fell over the course of 2014, and had a small bounce back in Q1 2015.

## 8 COMPLIANCE WITH TREASURY LIMITS AND PRUDENTIAL INDICATORS

8.4 During the financial year to March 2015, the Council operated within the treasury limits as set out in the TMS. The outturn for the Treasury Management Prudential Indicators are shown below.

External debt indicator	Approved limit (£m)	Maximum Borrowing in year	Days exceeded
Authorised limit <sup>1</sup>	486	285	None
Operational boundary <sup>2</sup>	466	285	None

Maturity structure of borrowing	Lower limit (%)	Upper limit (%)	Actual at 31 March 2014 (%)
Under 12 months	0	40	11.2
1-2 years	0	35	0.0
2-5 years	0	35	10.7
5-10 years	0	50	14.3
10 years and over	35	100	63.8

Upper limits on interest rate exposure	Approved maximum limit	Actual as at 31 March 2015
<b>Borrowing</b>		
Fixed interest rate exposures	100%	75.0%
Variable interest rate exposures <sup>3</sup>	50%	25.0%
<b>Investments</b>		
Fixed interest rate exposures	50%	4.1%
Variable interest rate exposures <sup>4</sup>	100%	95.9%

£ million	Approved maximum limit £m	Actual as at 31 March 2014 £m
Limit on investments for periods over 364 days	200	24.8

<sup>1</sup> Authorised limit for external debt is the limit above which external debt must not go without changing Council Policy.

<sup>2</sup> Operational boundary for external debt is the limit against which external debt will be constantly monitored.

<sup>3</sup> Variable interest rate include all debt under 1 year to maturity and LOBOs.

<sup>4</sup> Includes all investments with maturity less than 1 year.

## **9. THE WAY FORWARD**

- 9.1 The Council has a clear ambition to be a leader amongst its peers for effective performance of financial management, including treasury management function. As part of the tri-borough team for Treasury & Pensions, there is opportunity to learn from and influence other authorities to constantly improve the service.
- 9.2 Officers are currently exploring a range of options to improve on the treasury management and related investment strategies to ensure the best use of the available resources. During 2015/16 a report will be presented for Members to consider these future initiatives.

### **Background Papers**

#### **Cabinet Reports**

Treasury Management – Annual Strategy for 2014/15, including Prudential Indicators and Statutory Borrowing Determinations – 23rd Feb 2015.

**If you have any questions about this report, or wish to inspect one of the background papers, please contact Jackie Shute on 020 7641 1067 or [jshute@westminster.gov.uk](mailto:jshute@westminster.gov.uk).**