Brent	**Cabinet** **16 November 2015** Report from the Chief Finance Officer
	Wards Affected: ALL
2014/15 Treasury Management Outturn Report	

1. INTRODUCTION

1.1 This report updates members on Treasury Management activity and confirms that the Council has complied with its Prudential Indicators for 2014/15.

2. RECOMMENDATION

2.1 The Committee is asked to consider the 2014/15 Treasury Management outturn report, which has been seen by the Audit Committee and is also to be submitted to the Council, in compliance with CIPFA's Code of Practice on Treasury Management (the Code).

3. BACKGROUND

3.1 The Council's treasury management activity is underpinned by 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.

3.2 This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the CLG Investment Guidance.

3.3 The Council has borrowed money over the long term to support investment in the Council's infrastructure and also invests balances held for short periods. It 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 Council's treasury management strategy.

Economic background

3.4 The recovery in the UK continued with steady economic activity and growth. Q4 2015 GDP showed year-on-year growth of 2.4%. Much of the improvement came from the service sector, with contributions from production and construction. Retail sales, consumer confidence and house prices all increased over the year. However, business investment has recovered less convincingly, the recovery in productivity has been anaemic at best, and the twin deficits (trade and budget) remain a source of concern. CPI fell from 1.6% in March 2014 to 0% in March 2015, principally because of a considerable fall in energy prices over the autumn of 2014 but also reflecting lower core inflation, reducing the pressure on the Bank to raise rates. The fall in unemployment continued, down from 6.8% in March 2014 to 5.5% in March 2015. Some 31.1m people were in employment, but the amount of excess capacity remains uncertain, making it difficult to be confident how much inflationary pressure is in the economy. Earnings growth increased from 1.8% in March 2014 to 2.3% in March 2015. In April 2015, the next move in official rates was expected to be upwards but there was no expectation that it was imminent.

3.5 At present it is difficult to be confident that present levels of growth can be sustained due to:

- the Eurozone's ongoing struggle to show sustainable Geopolitical uncertainty arising from the situation in the Ukraine and the Middle East
- Evidence of increasing strains to the Chinese and other emerging economies, caused by a confluence of factors.

Gilt Yields and Money Market Rates

3.6 Gilt yields (the rate of interest on UK government borrowing) remained little changed until July 2014 and then fell in response to lower oil prices and the implication for inflation. Yields reached their low point (10 year yields at 1.33%) in January 2015 and then rose a little to finish the year at 1.19% (5 years), 1.57% (10 years) and 2.14% (20 years).

3.7 Interest rates on short term inter-bank lending remained below 1% through the year.

The Borrowing Requirement and Debt Management

3.8 The table below summarises the Council's borrowing activity during 2014/15. The Council's underlying need to borrow as measured by the Capital Financing Requirement (CFR) at 31/03/2015 was £579 million.

	Balance 01/04/2014 (£m)	New Borrowing (£m)	Borrowing Repaid (£m)	Balance 31/03/2015 (£m)	Average Rate (%)	Average Life (Years)
CFR	582			579		
Short Term Borrowing	0	75	75	0	0	
Long Term Borrowing	428	0	4	424	4.72	37.4
TOTAL BORROWING	428	75	79	424	4.72	37.4

3.9 At 1 April 2014 the Council had £428 million of long-term borrowing, to finance its previous years' capital programmes. With short-term interest rates being much lower than long-term rates, it was more cost effective in the short-term to use internal resources and borrow on a short-term basis (mainly from other local authorities), rather than undertake further long-term borrowing. By doing so, the Council has been able to reduce net borrowing costs and reduced overall treasury risk, because overall borrowing has been reduced slightly.

3.10 The Treasury Management Strategy approved by the Council in March 2015 states that the Council will maintain borrowing at the lowest level consistent with prudent management of the Councils finances. This implies that, at present discount rates, we will not undertake premature repayment of debt but that, in conjunction with our Treasury Management advisers, Arlingclose, we will remain abreast of developments and be prepared to borrow up to the level of CFR if a significant permanent rate rise appears likely. These circumstances did not arise during the year.

3.11 No debt was restructured during the year and no lenders exercised options to vary the terms of loans on LOBO (Lender Option, Borrower Option) terms. The Council has borrowed £95.5m under LOBO transactions, all of which were entered into in the period November 2002 to April 2010. Unlike PWLB loans, there is no formula for the cost of redemption of LOBOs, and the price quoted would depend on any bank's view on its commercial advantage. The banks' positions have been insured through the derivatives markets and to renegotiate these arrangements would be very expensive

3.12. There are complex arguments made about LOBOs, by their supporters and by their detractors. The Council's position is simply that the LOBOs are part of its portfolio, and must therefore be managed as effectively as possible. There are no plans to enter into further LOBO contracts. However, it should be noted that the average rate of interest being paid on LOBOs is little different to that on PWLB debt (4.75% compared to 4.71% at 31 March) and the range of rates lower. The most expensive LOBO was at 6.234% on 31 March, compared with the most expensive PWLB at 8.875%

3.13 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.

Investment Activity

3.14 Both CIPFA and the CLG Investment Guidance require the Council to invest prudently and have regard to the security and liquidity of investments before seeking the optimum yield. The table below summarises investment activity during 2014/15.

Investments	Balance on 01/04/2014 (£m)	Investments made (£m)	Investments repaid (£m)	Balance on 31/03/2014 (£m)	Average Rate (%)
Fixed Term Deposits	62	630	567	125	0.5
Money Money Market Funds and notice deposits	49	482	507	24	0.6
TOTAL INVESTMENTS	111	1112	1074	149	0.5

3.15 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 which defined "high credit quality organisations" as those having a long-term credit rating of A- or higher that are domiciled in the UK or overseas where the sovereign rating is

AA+ or higher. During the year, in response to the growth of bail in risk and following changed advice from Arlingclose, officers took the decision to restrict the maximum maturity with market financial institutions to three months and use only marketable instruments issued by them. Yields obtained were slightly reduced by this action, but it was felt to be a prudent response to the changed risk environment.

3.16 At the start of the year, investments with banks and building societies were primarily fixed-rate term deposits. The maximum duration of these investments was 12 months in line with the prevailing credit outlook during the year as well as market conditions. At the end of the year, the transition to marketable instruments was underway, and the latest commercial counterparty maturity was 4 August.

Credit developments and credit risk management

3.17 The Council assessed and monitored counterparty credit quality with reference to credit ratings; credit default swaps; GDP of the country in which the institution operates; the country's net debt as a percentage of GDP and share price. The minimum long-term counterparty credit rating determined by the Council for the 2014/15 treasury strategy was A- across rating agencies Fitch, S&P and Moody's.

3.18 The mechanism for dealing with a failed bank, which was brought into effect through the Financial Services (Banking Reform) Act 2013, is now largely in operation. The Council has taken a number of actions in response to this, and continues to monitor risks, with advice from Arlingclose. Some results of these are noted above (3.11 – 12)

3.19 The European Parliament approved the EU Bank Recovery and Resolution Directive (BRRD) on April 15, 2014. As a result, over 2014-15 Moody's revised the Outlook of several UK and EU banks from Stable to Negative (note, this is not the same as a rating review negative) and S&P placed the ratings of UK and German banks on Credit Watch with negative implications, following these countries' early adoption of the bail-in regime in the BRRD.

3.20 In December the Bank's Prudential Regulation Authority (PRA) stress tested eight UK financial institutions to assess their resilience to a very severe housing market shock and to a sharp rise in interest rates and address the risks to the UK's financial stability. Institutions which 'passed' the tests but would be at risk in the event of a 'severe economic downturn' were Lloyds Banking Group and Royal Bank of Scotland. Lloyds Banking Group, is taking measures to augment capital and the PRA does not require the group to submit a revised capital plan. RBS, which is not on the Authority's lending list for investments, has updated plans to issue additional Tier 1 capital. The Co-operative Bank failed the test. The Council banks with RBS

3.21 The Council did not make any deposits with institutions in the Eurozone during the year and took the action noted above on UK banks.

Liquidity Management

3.22 Combining changes to the regulatory environment and our adoption of a three month lending limit, investments with financial institutions are now normally by means of purchasing 3 month Certificates of Deposit (CDs). Longer maturities can be obtained by depositing with government bodies, either Central, via Treasury Bills up to 6 months, or Local, though attractive rates from Local Authorities are rare at the moment. At peak periods, mindful of the primacy of security as a criterion for decision making, substantial balances may be held in short term investments, particularly Money Market Funds. The use of short term borrowing at times of lower cash balances is judged to maintain a prudent balance between maintaining security and liquidity and achieving a reasonable yield on investments, though this is rarely required currently.

Yield

3.23 The UK Bank Rate was maintained at 0.5% through the year. Short term money market rates also remained at low levels which continued to have a significant impact on investment income. The average 3-month LIBID rate during 2014/15 was 0.5%, the 6-month LIBID rate averaged 0.67% and the 1-year LIBID rate averaged 0.95%. The low rates of return on the Council's short-dated money market investments reflect prevailing market conditions and the Council's objective of optimising returns commensurate with the principles of security and liquidity.

3.24 The Council's budgeted investment income for the year had been estimated at £0.6m. The average cash balance during the year was £153m during the period and interest earned was £0.9m.

Update on Investments with Icelandic Banks

3.25 ***Heritable*** – The Council has now recovered 94% of its £10 million deposit with Heritable Bank. It is likely that further distributions will be received, although the administrators have not made any further estimate of final recoveries yet. After the end of the year (in late August) a further £380,000 (3.8%) was received and a further distribution is expected, subject to the outcome of a legal case.

3.26 ***Glitnir*** – The Central Bank of Iceland undertook a final auction of the krone representing the final £1m outstanding and, after conversion of the proceeds to sterling, this realised £0.7m. The balance had already been provided for in previous year's Accounts

Compliance

3.27 The Council confirms that it has complied with its Prudential Indicators for 2014/15, which were approved by the Council on 2 March 2014 as part of the Council's Treasury Management Strategy Statement.

3.28 In compliance with the requirements of the CIPFA Code of Practice this report provides members with a summary report of the treasury management activity during 2014/15. None of the Prudential Indicators have been breached and a prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield. Further information is set out in Appendix 2.

Investment Training

3.29 The needs of the Council's treasury management staff for training in investment management are kept under review and considered as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change.

3.30 During 2014/15 staff attended training courses, seminars and conferences provided by Arlingclose and CIPFA and opportunities which may arise with other organisations are considered.

3.31 A member training session on treasury management was held on 24 November 2014 which outlined the overall treasury management framework with a particular focus on the management of risks.

4. FINANCIAL IMPLICATIONS

4.1 The Council's incurred interest costs of £20.0m in 2014/15 in respect of its long-term borrowing and earned interest of £0.9m on its investments.

5. LEGAL IMPLICATIONS

5.1 None identified.

6. DIVERSITY IMPLICATIONS

6.1 None identified.

7. STAFFING IMPLICATIONS

7.1 None identified.

8. BACKGROUND INFORMATION

Treasury Management Strategy Report to Council – 2 March 2015
2014/15 Mid Year Treasury Report to Council – 8 September 2014

9. CONTACT OFFICERS

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Appendix 1 - Debt and Investment Portfolio Position 31/3/2015

	31/3/2015 Actual Portfolio £m	**31/3/2015 Average Rate %**
External Borrowing:		
PWLB – Maturity	288	5.0
PWLB – Equal Instalments of Premium	40	2.6
LOBO Loans	96	4.8
Total External Borrowing	**424**	**4.7**
Other Long Term Liabilities:		
PFI	34	9.3
Total Gross External Debt	**458**	**5.1**
Investments:		
Deposits	62	0.7
Money Market Funds	49	0.4
Total Investments	**111**	**0.6**
Net Debt	**353**	**4.8**

Appendix 2 – Prudential Indicators

(a) Capital Financing Requirement (CFR)

The Council's cumulative maximum external borrowing requirement for 2014/15 is shown in the table below:

Capital Financing Requirement	31/03/2015 Estimate £m	31/03/2015 Actual £m
General Fund	445	442
HRA	137	137
Total CFR	**582**	**579**

Gross Debt and the Capital Financing Requirement: In order to ensure that over the medium term debt will only be for a capital purpose, the Council should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence.

Debt	31/03/2015 Estimate £m	31/03/2015 Actual £m
Borrowing		424
PFI liabilities		34
Total Debt	**615**	**458**
Borrowing in excess of CFR?	**No**	**No**

(b) Authorised Limit and Operational Boundary for External Debt

The Operational Boundary for External Debt is based on the Council's estimate of most likely, i.e. prudent, but not worst case scenario for external debt. It links directly to the Council's estimates of capital expenditure, the capital financing requirement and cash flow requirements and is a key management tool for in-year monitoring. Other long-term liabilities comprise finance lease, Private Finance Initiative and other liabilities that are not borrowing but form part of the Council's debt.

The Authorised Limit for External Debt is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Council can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

The Director of Finance confirms that there were no breaches to the Authorised Limit and the Operational Boundary during 2014/15.

	Operational Boundary (Approved) 31/03/2015	Authorised Limit (Approved) 31/03/2015	**Actual External Debt 31/03/2015**
Borrowing			424
Other Long-term Liabilities			34
Total	**680**	**780**	**458**

(c) Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure

This indicator is set to control the Council's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of net principal borrowed.

	Approved Limits for 2014/15 Proportion %	Maximum during 2014/15 Proportion %
Upper Limit for Fixed Rate Exposure	100	100
Compliance with Limits:	Yes	Yes
Upper Limit for Variable Rate Exposure	40	0
Compliance with Limits:	Yes	Yes

(d) Maturity Structure of Fixed Rate Borrowing

This indicator is to limit large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates.

Maturity Structure of Fixed Rate Borrowing	Upper Limit %	Lower Limit %	Actual Fixed Rate Borrowing at 31/03/2015 £m	% Fixed Rate Borrowing at 31/03/2015	Compliance with Set Limits?
under 12 months	40	0	40	10	Yes
12 months and within 24 months	20	0	29	8	Yes
24 months and within 5 years	20	0	49	11	Yes
5 years and within 10 years	60	0	18	4	Yes
10 years and within 20 years	100	0	26	6	Yes
20 years and within 30 years	100	0	1	0	Yes
30 years and within 40 years	100	0	101	24	Yes
40 years and within 50 years	100	0	160	37	Yes
50 years and above	100	0	0	0	Yes

(e) Capital Expenditure

This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits and, in particular, to consider the impact on Council tax and in the case of the HRA, housing rent levels.

Capital Expenditure	31/03/2015 Estimate £m	31/03/2015 Actual £m
Non-HRA	80	67
HRA	10	8
Total	**90**	**89**

(f) Ratio of Financing Costs to Net Revenue Stream

This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

Ratio of Financing Costs to Net Revenue Stream	31/03/2015 Estimate %	31/03/2015 Actual %
Non-HRA	9.76	7.37
HRA*	15.99	13.14
Total	10.76	8.00

(g) Adoption of the CIPFA Treasury Management Code

This indicator demonstrates that the Council adopted the principles of best practice.

The Council adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition* in February 2013

(h) Upper Limit for Total Principal Sums Invested Over 364 Days

The purpose of this limit is to contain exposure to the possibility of loss that may arise as a result of the Council having to seek early repayment of the sums invested.

	31/03/2015 Approved £m	31/03/2015 Actual £m
	20	0

(i) HRA Limit on Indebtedness

HRA Debt Cap (as prescribed by CLG)	£199m	
	31/03/2015 Estimate £m	31/03/2015 Actual £m
HRA CFR	137	137