AUDIT COMMITTEE 26 JUNE 2015

COUNCIL 13 JULY 2015

TREASURY MANAGEMENT ANNUAL OUTTURN REPORT 2014/15

1. PURPOSE

1.1. New Forest District Council adopts the key recommendations of the Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management in the Public Services: Code of Practice, which includes an annual report on the treasury management strategy after the end of each financial year.

2. SUMMARY

2.1. Treasury management in the context of this report is defined as:

"The management of the organisation's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

2.2. This annual report sets out the performance of the treasury management function during 2014/15, to include the effects of the decisions taken and the transactions executed in the past year.

2.3. Overall responsibility for treasury management remains with the Council. No treasury management activity is without risk; the effective identification and management of risk are integral to the Council's treasury management objectives.

2.4. All treasury activity has complied with the Council's Treasury Management Strategy and Investment Strategy for 2014/15, and all relevant statute, guidance and accounting standards. In addition the Council's treasury advisers, Arlingclose, provide support in undertaking treasury management activities.

2.5. The Council has complied with all of the prudential indicators set in its Treasury Management Strategy; these are detailed fully in Appendix 1.

3. ECONOMIC BACKGROUND

Growth and Inflation

3.1. 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.

3.2. 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

3.3. 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

3.4. The Bank of England's Monetary Policy Committee (MPC) maintained interest rates at 0.5% and asset purchases (Quantitative Easing) 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 responding 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.

3.5. Arlingclose's expectation for the first rise in official interest rates remains quarter 2 of 2016. The risks to this forecast remain weighted to the downside; in particular, signs of more widespread deflation or political uncertainty could prompt a further downward revision to the forecast. Arlingclose projects a slow rise in the Bank Rate. The pace of interest rate rises will be gradual and the extent of rises limited.

3.6. A continuation of Base Rates being held at record lows has limited the return that can be made for investment balances. Despite positive economic indicators there remain risks for investors due to the UK banks 'bail-in' legislation. The credit risk associated with making unsecured bank deposits will increase relative to the risk of other investment options available to the Council. Whilst the likelihood of suffering a loss from the default of a bank remains relatively unchanged, the 'bail-in' regime has significantly increased the impact a default would have in terms of the scale of loss the Council could be exposed to.

4. LOCAL CONTEXT

4.1. At 31/03/2015 the Council's underlying need to borrow for capital purposes as measured by the Capital Financing Requirement (CFR) was £148.3m, while usable reserves and working capital which are the underlying resources available for investment were £50.3m.

4.2. At 31/03/2015, the Council had £144.5m of borrowing and £50.0m of principal investments. The Council's current strategy is to maintain borrowing and investments below their underlying levels, referred to as internal borrowing.

4.3. The Council's CFR is forecast to remain relatively stable over the coming years but is currently planned to reduce in 2017/18 as the first instalment of the HRA settlement is due for repayment, and its capital expenditure plans do not currently imply any need to borrow over the forecast period.

5. BORROWING STRATEGY

5.1. At 31/03/2015 the Council held £144.5m of loans, (a decrease of £0.2m on 31/03/2014) as part of its strategy for funding previous years' capital programmes.

5.2. The Council's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Council's long-term plans change being a secondary objective.

5.3. Affordability and the "cost of carry" remained important influences on the Council's borrowing strategy alongside the consideration that, for any borrowing undertaken ahead of need, the proceeds would have to be invested in the money markets at rates of interest significantly lower than the cost of borrowing.

5.4. The Council's portfolio of long-term debt is in the form of loans from the Public Works Loan Board (PWLB). A cautious approach has been applied in terms of take-up of new borrowing to minimise debt interest payments without compromising the long-term stability of the portfolio. No new borrowing took place during 2014/15. Internal resources in lieu of external borrowing have been used to lower overall treasury risk by reducing both external debt and temporary investments.

Table 1: Borrowing Activity in 2014/15

	Balance on 31/03/2014 £m	Maturing Debt £m	Balance on 31/03/2015 £m	Avg Rate %
CFR	147.7		148.3	
Short Term Borrowing[1]	0.2	0.0	0.2	2.58%
Long Term Borrowing	144.5	(0.2)	144.3	3.12%
TOTAL BORROWING	144.7	(0.2)	144.5	3.12%
Other Long Term Liabilities	0.0	0.0	0.0	
TOTAL EXTERNAL DEBT	144.7	(0.2)	144.5	3.12%
Increase/ (Decrease) in Borrowing £m			(0.2)	

Debt Rescheduling

5.5. The premium charge for early repayment of PWLB debt remained relatively expensive for the loans in the Council's portfolio and therefore unattractive for debt rescheduling activity. No rescheduling activity was undertaken as a consequence.

Abolition of the PWLB

5.6. 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 PWLB. 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 Council intends to use the PWLB's replacement as a potential source of borrowing if required.

6. INVESTMENT ACTIVITY

6.1. The European Parliament approved the EU Bank Recovery and Resolution Directive (BRRD) on April 15, 2014. The combined effect of the BRRD and the UK's Deposit Guarantee Scheme Directive (DGSD) is to promote deposits of individuals and SMEs above those of public authorities, large corporates and financial institutions. Other EU countries, and eventually all other developed countries, are expected to adopt similar approaches in due course.

6.2. The outlawing of bail-outs, the introduction of bail-ins, and the preference being given to large numbers of depositors other than local authorities, means that the risks of making unsecured deposits rose relative to other investment options. The Council therefore has attempted to diversify

[1] Loans with maturities less than 1 year.

through investing in secured covered bonds, non-bank investments and pooled funds.

6.3. The Council has held invested funds representing income received in advance of expenditure plus balances and reserves held. During 2014/15 the Council's investment balances have ranged between £45.5 and £73.8 million.

6.4. The Guidance on Local Government Investments in England gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles.

Table 2: Investment Activity in 2014/15

Investments	Balance on 31/03/2014 £m	Balance on 30/03/2015 £m	Average Rate on 31/03/2015	Average Life on 31/03/2015 (years)
Short term Investments (call accounts, deposits, covered bonds) - Banks & Building Societies - Local Authorities	30.11	26.64	0.69%	0.35
Long term Investments - Banks & Building Societies - Local Authorities	0.00	4.02	1.50%	2.48
Money Market Funds	10.95	14.48	0.46%	0.00
Other Pooled Funds	0.00	2.04	6.70%[2]	n/a
Corporate Bonds (unsecured)	0.00	3.07	0.84%	0.73
TOTAL INVESTMENTS	41.06	50.25	0.94%	0.67
Increase/ (Decrease) in Investments £m		9.19		

6.5. During 2014/15, the Council diversified its investments by investing in certificates of deposits with approved counterparty banks, bonds including fixed bonds and covered floating rate notes, long-term pooled property funds, fixed deposits with local authorities, and by opening two further new money market funds. During 2014/15 the Council also committed to investing £1.05m in to a second pooled property fund, however the funds for this were not called until April 2015.

6.6. Security of capital has remained the Council's main investment objective. This has been maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2014/15.

6.7. Counterparty credit quality was assessed and monitored with reference to credit ratings, credit default swap prices, financial statements, information on potential government support and reports in the quality financial press.

[2] Rate of return based on 8 months of monthly returns.

7. INVESTMENT OUTTURN

7.1. The Council maintained a sufficient level of liquidity through the use of call accounts and money market funds. The Council sought to optimise returns commensurate with its objectives of security and liquidity. The UK Bank Rate has been maintained at 0.5% since March 2009 and short-term money market rates have remained at relatively low levels which continued to have a significant impact on cash investment income.

7.2. The Council's average cash balances were £58.5m during the year and interest earned for the year was £425,000, giving a yield of 0.73%.

8. COMPLIANCE WITH PRUDENTIAL INDICATORS

8.1. The Council confirms compliance with its Prudential Indicators for 2014/15, which were set in February 2014 as part of the Council's Medium Term Financial Plan 2013 to 2017, and Budget & Council Tax Report 2014-2015.

9. TREASURY MANAGEMENT INDICATORS

9.1. The Council measures and manages its exposures to treasury management risks using the following indicators.

Interest Rate Exposures

9.2. 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 amount of net principal borrowed will be:

Table 4 – Interest Rate Exposures

	Approved Limits for 2014/15	Maximum during 2014/15	Compliance with Limits:
Upper limit on fixed interest rate investment exposure	£10.0m	£7.0m	Yes
Upper limit on variable interest rate investment exposure	£67.0m	£71.8m	No
Upper limit on fixed interest rate borrowing exposure	£180.0m	£144.7m	Yes
Upper limit on variable interest rate borrowing exposure	£90.0m	£1.0m	Yes

9.3. Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate.

9.4. During 2014/15 the upper limit on variable interest rate investment exposure was breached as £71.8m was invested against a limit of £67m. This was due to the fact that cash balances for the Council were much greater than forecast. In the 2015/16 Treasury Management Strategy this limit has been increased to £80m.

Maturity Structure of Borrowing

9.5. This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

Table 5 – Maturity Structure of Borrowing

	Upper	Lower	Actual
Under 12 months	25%	0%	0.1%
12 months and within 24 months	25%	0%	0.1%
24 months and within 5 years	25%	0%	8.9%
5 years and within 10 years	25%	0%	14.7%
10 years and above	100%	0%	76.2%

Principal Sums Invested for Periods Longer than 364 days

9.6. The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total principal sum invested to final maturities beyond the period end will be:

Table 6 – Principal Sums Invested for Periods Longer than 364 days

	2014/15	2015/16	2016/17
Limit on principal invested beyond year end	£10m	£20m	£20m
Actual	£6m		

10. CRIME AND DISORDER AND ENVIRONMENTAL IMPLICATIONS

10.1. None arising directly from this report.

11. RECOMMENDATIONS

Members are recommended to:

11.1. consider the performance of the treasury function detailed in this report.

Further information	**Background papers**
Please contact Andrew Boutflower (HCC), or Bob Jackson (Executive Director)	The Prudential Code, CIPFA Guidance Notes and ODPM Investment Guidance
	Local Government Act 2003
email: andrew.boutflower@hants.gov.uk bob.jackson@nfdc.gov.uk	SI 2003/3146 Local Authorities (Capital Finance and Accounting) (England) Regulations 2003
	Council 24 February 2014 – Audit Committee -Treasury Management Strategy Report 2014/15 Council 23 January 2015 – Audit Committee Council 14 July 2014 – Audit Committee - Treasury Management Annual Outturn Report 2013/14 - Treasury Management Strategy Report 2015/16
	Published Papers

Appendix 1

PRUDENTIAL INDICATORS 2014/15

The Local Government Act 2003 requires the Council to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Council has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

Estimates of Capital Expenditure

The Council's planned capital expenditure and financing may be summarised as follows.

Capital Expenditure and Financing	2014/15 Approved £'000	2014/15 Revised £'000	2014/15 Actual £'000	2015/16 Estimate £'000	2016/17 Estimate £'000
General Fund	7,238	6,415	**4,303**	8,526	5,949
HRA	13,920	14,090	**13,670**	12,718	12,250
Total Expenditure	**21,158**	**20,505**	**17,973**	**21,244**	**18,199**
Capital Receipts	1,074	1,074	**2,797**	326	276
Grants	868	1,248	**1,069**	2,269	1,165
Reserves	956	549	**-**	973	575
Revenue	12,433	13,445	**11,134**	12,668	12,250
Developers Contributions	1,231	2,190	**1,269**	3,786	2,492
Borrowing	4,596	1,999	**1,704**	1,222	1,441
Total Financing	**21,158**	**20,505**	**17,973**	**21,244**	**18,199**

Estimates of Capital Financing Requirement

The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose.

Capital Financing Requirement	**31.03.15 Approved £'000**	**31.03.15 Revised £'000**	**31.03.15 Actual £'000**	**31.03.16 Estimate £'000**	**31.03.17 Estimate £'000**
General Fund	7,174	4,008	**3,687**	3,857	4,157
HRA	144,601	144,601	**144,601**	144,601	144,601
Total CFR	**151,775**	**148,609**	**148,288**	**148,458**	**148,758**

The CFR is forecast to rise by £470,000 over the next three years as capital expenditure financed by debt outweighs resources put aside for debt repayment.

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	**31.03.15 Approved £m**	**31.03.15 Revised £m**	**31.03.15 Actual £m**	**31.03.16 Estimate £m**	**31.03.17 Estimate £m**
Borrowing	145.9	144.5	**144.5**	144.3	144.1

Total debt is expected to remain below the CFR during the forecast period.

The actual debt levels are monitored against the Operational Boundary and Authorised Limit for External Debt, below.

Operational Boundary for External Debt

The operational boundary is based on the Council's estimate of most likely, i.e. prudent, but not worst case scenario for external debt.

Operational Boundary	**2014/15 Approved £m**	**2014/15 Revised £m**	**2014/15 Actual £m**	**2015/16 Estimate £m**	**2016/17 Estimate £m**
Borrowing	146.0	163.6	**144.5**	163.4	163.7

Authorised Limit for External Debt

The authorised limit 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.

Authorised Limit	2014/15 Approved £m	2014/15 Revised £m	2014/15 Actual £m	2015/16 Estimate £m	2016/17 Estimate £m
Borrowing	179	178.6	**144.5**	178.4	178.7

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	2014/15 Approved %	2014/15 Actual %	2015/16 Estimate %	2016/17 Estimate %
General Fund	0.7%	0.1%	0.2%	0.2%
HRA	0.0%	0.0%	0.0%	0.0%

Incremental Impact of Capital Investment Decisions

This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax and housing rent levels. The incremental impact is the difference between the total revenue budget requirement of the current approved capital programme and the revenue budget requirement arising from the capital programme proposed.

Incremental Impact of Capital Investment Decisions	2014/15 Approved £	2014/15 Actual £	2015/16 Estimate £	2016/17 Estimate £
General Fund - increase in annual Band D Council Tax	£1.16	£0.81	£1.61	£1.99
HRA - increase in average weekly rents	£2.72	£13.30	£0.19	(£0.89)

Adoption of the CIPFA Treasury Management Code

The Council adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice on 25 February 2002 and complies with all revisions to the Code.