North Somerset Council

REPORT TO THE AUDIT COMMITTEE

DATE OF MEETING: 10 SEPTEMBER 2015

SUBJECT OF REPORT: TREASURY MANAGEMENT OUT-TURN 2014/15

TOWN OR PARISH: ALL

OFFICER/MEMBER PRESENTING: MALCOLM COE, HEAD OF FINANCE & PROPERTY

KEY DECISION: NO

RECOMMENDATIONS

The Audit Committee is asked to;

- note the council's performance in carrying out its treasury management activities in 2014/15
- note the request to the Executive to delegate responsibility to amend the treasury management strategy to the council's S151 Officer at their meeting on 8 Sept 2015

1. SUMMARY OF REPORT

This report informs the Audit Committee of the council's;

- treasury management activities during 2014/15, and confirms that the transactions during the year complied with the approved Treasury Management Policy, *in accordance with the requirement of the council's Accountability and Responsibility Framework* .
- prudential indicators for 2014/15, *as required by CIPFA's Prudential Code for Capital Finance in Local Authorities*.

2. POLICY

Treasury activities during 2014/15 were carried out in accordance with the Treasury Management Policy approved by Council in February 2014.

3. DETAILS

External Investments - Background

Members will be aware that the council has an in-house treasury team who manage the overall cash-flow activities, including both investments and borrowing transactions on a daily basis, and in addition also utilise the services of an external fund manager, Tradition UK, to manage a proportion of the council's investment balances on our behalf.

The council's approved Investment Strategy aims to be flexible and to offer the ability to operate a mixed portfolio, with funds divided between in-house and external fund manager, thereby allowing the council to take advantage of a range of investment opportunities and market conditions, that may occur throughout the year, as well as enabling the council to diversify both credit and counter-party risk by allowing the council to invest in higher-rated institutions via our fund manager.

During 2014/15 the majority of the council's investments were made utilising fixed-term cash deposits, which can sometimes limit the level of interest return available however, they do offer the protection of the principal sums invested, which means that by using these investments the council is significantly reducing the risk of capital losses.

The primary objective of the council's internal treasury management team is to manage the overall cash-flows, which at times can be volatile and fluctuate significantly during the months and year. These fluctuations bring constraints when reviewing potential investment opportunities, which therefore impact upon the potential level of investment returns achievable. The external fund managers have no cash-flow or timing constraints, they have the primary objective of maximising the return on the investments managed within the various risk parameters of the council's Investment Strategy and returns would be expected to be much higher.

External Investment Balances

At the year-end the council's external investments totalled £82m, which is an increase on the £67.24m recorded at the end of the previous year. This sum includes monies managed by the council's in-house team during the year as well those sums managed by the council's external fund manager. During the year more investments were placed with maturity dates beyond one year compared to the previous year, which enabled the council to capture slightly higher returns than those investments with shorter durations.

Analysis of Investments (principal sums)			
	NSC Cash Deposits £m	Tradition UK Ltd £m	**TOTAL £m**
Investments maturing in less than 1 year	35.00	21.00	**56.00**
Investments maturing after 1 year	17.00	9.00	**26.00**
Investment Balance – 31 March 2015	**52.00**	**30.00**	**82.00**
Investments maturing in less than 1 year	33.25	27.00	**60.25**
Investments maturing after 1 year	3.99	3.00	**6.99**
Investment Balance - 31 March 2014	37.24	30.00	**67.24**

The table below shows further analysis of the investments held at 31 March 2015, compared to the same period last year.

Analysis of Investments (principal sums) –			
	31/3/2015 £m	31/3/2014 £m	Movement £m
UK Banks	**24.00**	22.00	+2.00
Overseas Banks	**0.00**	1.24	-1.24
UK Building Societies	**48.00**	41.00	+7.00
Local Authorities	**5.00**	0.00	+5.00
Debt Management Office	**5.00**	3.00	+2.00
TOTAL INVESTMENTS – 31 March	**82.00**	**67.24**	**+14.76**

Investment Performance in 2014/15

The table below shows the average rates of return achieved during 2014/15 on investments placed by both of the treasury teams.

	In-house		Tradition	
	Ave Return (%)	Ave Duration (days)	Ave Return (%)	Ave Duration (days)
Quarter 1 – b/fwd and to June 2014	0.94%	247	1.14%	174
Quarter 2 – to September 2014	0.63%	76	1.14%	432
Quarter 3 – to December 2014	0.57%	92	1.11%	548
Quarter 4 – to March 2015	0.33%	34	1.12%	548
Annual Averages	**0.84%**	121	**1.13%**	364
Benchmark	0.32%	n/a	0.32%	n/a

It can clearly be seen that both categories of investments exceeded the annual benchmark comparisons for the year, although it should be noted that the official benchmark, which is largely driven by the bank base rate, continued to remain at an all-time low throughout the year and so does make a simple comparison to the defined benchmark less relevant.

The table shows that the council's in-house team achieved a lower average rate of return during the year from its investments placed than that of the external fund manager, however the table also shows that the 'duration' of investments placed by each team differs significantly, and it is this factor which impacts on the interest rate achieved with the yield curve offering higher rates of return for longer investment periods. The primary function of the council's treasury team is to mange cash-flows which means that although cash balances can be high at the start of any given week, they may easily be required in the next week, meaning that the council can only invest them for a limited duration, often at very low rates.

Investment Interest Budgets 2014/15

The table below shows that the council achieved £1.010m in interest during the year, which is £0.035m less than budgeted.

	In-House – Cash Deposits £000	In-House – MM Funds £000	Tradition UK Ltd £000	**TOTAL £000**
Actual Interest Generated	640	12	358	**1,010**
Investment Interest Budget	639	45	361	**1,045**
Variance to Budget	1	-33	-3	**-35**

As mentioned above, the external fund manager does not have any of the daily constraints of managing the council's financial activities and is therefore more able to respond to investment opportunities within the market-place or lock funds away for longer durations, thereby enabling the council to maximise higher returns.

Should additional funds be managed either in this way or by utilising other investment products then the council could generate higher returns on a larger proportion of the council's balances. Officers are currently reviewing the level of cash-flow balances available to determine if this course of action should be accommodated during 2015/16 and will update Members of any changes or actions during the mid-year treasury management report which will be considered by the Executive in October 2015.

Long-term Borrowing 2014/15

During the year the council repaid the following loans which had reached their maturity dates.

Long-term Borrowing repaid during 2014/15				
	Ref	Principal £m	Interest Rate %	Maturity Date
Loan repaid at maturity	PWLB 7	1.43m	5.38%	31/3/2015
Loan repaid at maturity	PWLB 9	0.57m	5.38%	31/3/2015
Loan repaid at maturity	PWLB 45	0.19m	1.83%	31/3/2015

The council also arranged the following new loans, all of which were with the Public Works Loan Board thereby utilising either the Certainty or the Project rates they offer which enable local authorities to receive beneficial interest rates compared to external markets. It should be noted that all of these new loans financed approved capital expenditure and the associated interest payment implications are either contained within the council's existing revenue budget or will be reimbursed by contributions from the City-Region Deal.

New Long-term Borrowing arranged during 2014/15				
	Rate Type	Principal £m	Interest Rate %	Maturity Date
School assets, funded by DSG	Certainty -0.2%	0.56m	3.66%	31/3/2039
Invest-to-Save proposals	Certainty -0.2%	0.47m	3.23%	31/3/2028
Corporate capital programme	Certainty -0.2%	6.35m	3.68%	31/3/2041
Vehicles	Certainty -0.2%	0.10m	2.11%	31/3/2019
Highways infrastructure	Certainty -0.2%	0.44m	3.62%	31/3/2037
NSETC and North-South Link, funded by City-Region Deal	Project -0.4%	4.70m	2.47%	31/3/2028

As can be seen from the table below, the council's long-term debt totals £124.23m and is profiled for repayment between March 2016 and March 2052 with no more than £7.3m repayable in any one year. This is in accordance with the council's current borrowing policy and is structured in a way to reduce exposure to significant cash-flow movements and adverse interest rates at the time each loan matures.

Repayment periods	PWLB £m	Ave Rate %
Less that 1 year	5.27	4.22%
Between 1 and 2 years	3.40	3.81%
Between 2 and 5 years	6.10	4.33%
Between 5 and 10 years	13.34	4.94%
Over 10 years	96.12	4.04%

Prudential Indicators

A key element of control under the Local Government Act 2003 capital financing system is that exercised by the statutory CIPFA Prudential Code. Under this system individual authorities are responsible for deciding the level of their affordable borrowing as opposed to the previous system of credit approvals issued by the Government.

Under the Code councils are required to establish certain key Prudential Indicators for both Treasury Management and Capital Financing activities. The actual level of these indicators for 2014/15 are shown in Appendix 1.

As can be seen from this Appendix the actual indicators for the year were within the budgeted levels approved by Council in February 2014, as part of the MTFP process.

Minimum Revenue Provision (MRP) 2014/15

When the council funds capital expenditure by long-term borrowing, the costs are charged to the council tax payer in future years, reflecting the long-term use of the assets. There are two elements to this cost;

- the interest on actual borrowing undertaken is charged in the year it is payable, and
- the principal (or capital) repayment element is charged as a “minimum revenue provision” (MRP).

Statutory regulations prescribe the minimum levels which must be charged to the councils revenue budget each year, however in addition to this ‘minimum’ payment, the council is also required to make additional voluntary repayments of capital for new loans entered into using the prudential borrowing powers, first having demonstrated that such borrowing is prudent, affordable and sustainable.

The council is required to approve an annual statement which details its policy for determining the level of capital repayments to be charged to its revenue accounts. The statement below covers the 2014/15 charges within the revenue accounts, in accordance with these requirements.

The MRP charge for 2014/15 of £4.777m was calculated using the methodology prescribed by the regulations in force during this time, which spreads the repayment of capital evenly over a 25 year period.

In addition, the council made a Voluntary Provision of £2.279m, based upon the useful economic lives of assets financed by unsupported borrowing prior to 2013/14, thereby following the prudent approach included within the guidance which is intended to match the borrowing liability to the benefits of the capital assets acquired using this source of finance, rather than over the minimum period of 25 years.

Review of the Treasury Management Strategy

Since the current treasury strategy was approved in February, the outlook for credit (or counterparty) risk for the council has largely remained unchanged although the council is aware that credit ratings for institutions are relative, rather than absolute measures of credit risk. In addition the returns on the fixed-term cash deposit investments has also remained relatively flat and unchanged offering low yields on principal sums invested.

The council continues to monitor the returns and risks in this area, and would look to review and amend either its lending criteria, investment vehicles or timescales in order to potentially generate higher returns whilst maintaining risk levels. Any such changes would increase the overall flexibility of the Strategy itself and also potentially increase the returns generated on investment balances.

Although no immediate changes are sought at this time, it is proposed that any amendments to the current Strategy be delegated to the council's Section 151 Officer for approval.

4. CONSULTATION

None

5. FINANCIAL IMPLICATIONS

Financial implications are contained throughout the report.

It should be noted that both the investment and borrowing values shown throughout the report reflect the principal sums of the investments held by the council at the end of the financial year, however accounting legislation requires the council to reflect either the fair and amortised cost valuations within its Statement of Accounts, which means that the figures will be presented differently there.

6. RISK MANAGEMENT

The council does face significant types and degrees of risk in this area, from both internal and external sources. However the council has implemented, and adheres to, strict policies and internal controls in order to mitigate such risks.

The council's primary objectives for the management of its investments are to give priority to the security and liquidity of its funds before seeking the best rate of return. The majority of its surplus cash is therefore held as short-term investments, and utilises the UK Government and highly rated banks and pooled funds where appropriate.

The council's primary objective for the management of its debt is to ensure its long-term affordability. The majority of its loans have therefore been borrowed from the Public Works Loan Board at long-term fixed rates of interest.

However, the combination of short duration investments and long duration debt can expose the council to the risk of falling investment income during periods of low interest rates. This risk is partially mitigated by the inclusion of some longer-term investments and the option to prematurely repay some long-term loans.

The council measures its exposure to credit risk by monitoring the individual credit ratings of each investor within its portfolio on at least a monthly basis.

7. EQUALITY IMPLICATIONS

None

8. CORPORATE IMPLICATIONS

None

9. OPTIONS CONSIDERED

N/a

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BACKGROUND PAPERS

Cash Manager reports from Tradition UK

PRUDENTIAL INDICATORS

1.1 Introduction

The CIPFA Prudential Code for Capital Finance in Local Authorities sets out the factors, or indicators that must be considered by each local authority when making decisions about capital investment and associated borrowing.

1.2 Treasury Management Prudential Indicators

The following Treasury Management prudential indicators were set for 2014/15 as part of the MTFP process. The estimates are shown below together with the actual indicators for 2014/15.

1.2.1 In respect of its external debt, the council approved the following authorised limit for its total external debt gross of investments for 2014/15. This limit separately identifies borrowing from other long-term liabilities such as finance leases or lease premium incentives. The actual level of external debt is shown, and is well within the limits set at the start of the year.

Authorised Limit for External Debt	2014/15 Limit £m	2014/15 Actual £m
Borrowing – NSC	189.0	123.233
Borrowing – Former Avon CC	17.0	15.652
Other Long Term Liabilities	17.0	3.106
Authority Total	**223.0**	**142.990**

1.2.2 The council also approved the following operational boundary for external debt for the same period. The operational boundary for external debt was based on the same estimates as the authorised limit, but reflected estimates of the most likely, prudent, but not worst case scenario, without the additional headroom included within the authorised limit to allow for unusual cash movements. As can be seen below, the actual level of external debt is well within the operational boundary set at the start of the year.

Operational Limit for External Debt	2014/15 Limit £m	2014/15 Actual £m
Borrowing – NSC	182.0	123.133
Borrowing – Former Avon CC	17.0	15.652
Other Long Term Liabilities	13.0	3.106
Authority Total	**212.0**	**142.990**

1.2.3 North Somerset Council has adopted CIPFA's Code of Practice for Treasury Management in the Public Services. In accordance with this Code the council set an upper limit on its variable interest rate exposures for 2014/15 debt. The upper limit was set at 20% of its net outstanding principal sums. The actual percentage of variable interest rate exposure was 0% for 2014/15 as the council does not have any long-term debt secured using variable rates.

The upper limit set for 2014/1 fixed interest rate exposures was £223m and the actual value of long-term debt at the year-end was £142.990m.

The council also set upper and lower limits for the maturity structure of its borrowings for 2014/15. These limits are shown below, together with the actual percentage of borrowing that is maturing in each period.

Maturity Structure of Borrowing	Upper Limit	Lower Limit	Actual 2014/15
Under 12 months	20%	0%	4%
12 months and within 24 months	30%	0%	3%
24 months and within 5 years	40%	0%	5%
5 years and within 10 years	50%	0%	11%
10 years and above	100%	10%	77%

1.2.4 The purpose of the prudential indicator in respect of investments is to contain the exposure to a loss in the event that early redemption of an investment is required. The council is required to set a maximum amount to be invested beyond the end of the financial year for the forthcoming financial year and the following two years.

	2014/15 Limit	2014/15 Actual
Upper Limit of Principal sums invested beyond the year	£85m	£26m

1.3 Other Prudential Indicators

The first indicator details the Capital Expenditure incurred by the council and charged to the capital programme. The actual spend for 2014/15 is shown below, alongside the revised estimated spend for 2014/15. The lower actual figure is due to slippage of the capital programme within education and strategic transport schemes.

Capital Expenditure	2014/15 Revised £000	2014/15 Actual £000
Total Spend	56,107	46,380

1.3.2 The ratio of financing costs to net revenue stream for 2014/15 is shown below. Reduced levels of capital expenditure and external borrowing undertaken during the year, have resulted in a ratio lower to that estimated.

Ratio of Financing Costs to Net Revenue Stream	2014/15 Estimate %	2014/15 Actual %
Ratio	9.50	8.25

APPENDIX 1

1.3.3 The actual capital financing requirement for the authority at 31st March 2015, together with the estimated requirement is shown below;

Capital Financing Requirement	**2014/15 Estimate £000**	**2014/15 Actual £000**
CFR Total	143,356	135,941

1.3.4 The capital financing requirement measures the authority's underlying need to borrow for a capital purpose. In accordance with best professional practice, North Somerset Council does not associate borrowing with particular items or types of expenditure. The council has, at any point in time, a number of cash-flows, both positive and negative, and manages its treasury position in terms of its borrowings and investments in accordance with its approved treasury management strategy and practices. In day-to-day cash management, no distinction can be made between revenue cash and capital cash. External borrowing arises as a consequence of all the financial transactions of the authority and not simply those arising from capital spending. In contrast, the capital financing requirement reflects the authority's underlying need to borrow for a capital purpose.

1.3.5 CIPFA's *Prudential Code for Capital Finance in Local Authorities* includes the following as a key indicator of prudence:

> "In order to ensure that over a medium term net borrowing will only be for a capital purpose, the local authority should ensure that net external borrowing does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any two additional capital financing requirement for the current and next two financial years."

The Head of Finance & Property as the council's S151 Officer, reports that the authority has met this requirement in 2014/15.