Annual Report 2013/14
Treasury Management and Actual Prudential Indicators

1. Introduction

1.1 The Council's treasury management activities are regulated by a variety of professional codes and statutes and guidance:

- The Local Government in Scotland Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;
- The Act permits the Scottish Ministers to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions were made in 2013/14); and
- Statutory Instrument (SSI) 29 2004, requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities, and therefore to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services; and the treasury activity with regard to the CIPFA Code of Practice for Treasury Management in Local Authorities.

1.2 This Council has adopted the CIPFA Code of Practice for Treasury Management in the Public Sector and operates its treasury management service in compliance with this Code and the above requirements. These require that the prime objective of the treasury management activity is the effective management of risk, and that its borrowing activities are undertaken in a prudent, affordable and sustainable basis.

1.3 During 2013/14 the minimum reporting requirements were that the Council receive an annual treasury strategy in advance of the new financial year, a mid-year report and an annual report following the financial year-end describing the activity compared to the strategy (this report).

1.4 This report sets out:

- A summary of the strategy agreed for 2013/14;
- The Council's treasury position at 31 March 2014;
- The main Prudential Indicators and compliance with limits;
- A summary of the economic factors affecting the strategy over 2013/14;
- The Treasury activity during 2013/14;
- Performance indicators set for 2013/14; and
- Risk and Performance.

2. A Summary of the Strategy Agreed for 2013/14

2.1 The expectation for interest rates within the strategy for 2013/14 anticipated a low but rising Bank Rate (starting in quarter 4 of 2014) with similar gradual rises in medium and longer term fixed borrowing rates over 2013/14. 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 counterparty risk considerations, resulting in relatively low returns compared to borrowing rates. As a result, the Council chose to take a cautious approach to its strategy and took necessary actions on borrowings, investments and debt rescheduling, in conjunction with market conditions at that time

3. The Council's Treasury Position at 31 March 2014

3.1 During 2013/14, the Head of Finance and Resources managed the debt position with the use of internal funds as well as external borrowing, and the treasury position at 31 March 2014 compared with the previous year was:

Table 1

Treasury position	31 March 2014		31 March 2013	
	Principal	Average Rate	Principal	Average Rate
Fixed Interest Rate Debt	£254.772m	4.23%	£217.766m	5.05%
Variable Interest Rate Debt	£0.461m	0.50%	£0.461m	0.77%
Total Debt	**£255.233m**	**4.22%**	**£218.226m**	**5.04%**
Total Investments	**£4.652m**	**0.56%**	**£2.244m**	**0.59%**
Net borrowing position	**£250.481m**		**£215.982m**	

3.2 From the above table, it can be seen that the average interest rate on debt held on 31 March 2014 has reduced from 5.04% to 4.22%. At the same time the average interest rate has reduced on the investments held on 31 March 2013 to 2014 from 0.59% to 0.56%.

3.3 There are four treasury prudential indicators which cover the activity of the treasury function within certain limits, thereby reducing the risk of an adverse movement in interest rates impacting negatively on the Council's overall position:

- Upper limits on variable rate exposure;
- Upper limits on fixed rate exposure;
- Maturity structures of borrowing; and
- Total principal funds invested for greater than 364 days. During 2013/14 the Council decided not to invest for longer than 364 days, so this indicator is set at nil.

3.4 The indicators within table 2 shows the actual upper limits for debt type and maturity as at 31 March 2014. The indicator for borrowing due within 12 months at the year end was 53.4% compared to the prudential limit of 50%, however this position was corrected shortly thereafter. This temporary position was due to a strategy of using short term borrowing to fund long term capital investment enabling the Council to take advantage of lower interest rates. There are no statutory or regulatory consequences of breaching this limit as it is for each local authority to set appropriate limits with regard to debt maturity. The prudential code states that the requirement to set indicators for debt maturity will not "unreasonably fetter" the discretion of an authority to take advantage of favourable debt restructuring opportunities.

Table 2

	2013/14 Actual	**2013/14 Revised Indicator**	
Upper limits on variable interest rates *(against maximum position)*	0.18%	50%	
Upper limits on fixed interest rates *(against maximum position)*	99.82%	100%	
Maturity structure fixed rate borrowing *(%)*	**Year end Position**	**Max**	**Min**
Under 12 months	53.4%	50%	0%
12 months to 2 years	3.2%	50%	0%
2 years to 5 years	22.2%	50%	0%
5 years to 10 years	1.7%	50%	0%
10 years to 20 years	3.1%	50%	0%
20 years to 30 years	0.8%	50%	0%
30 years to 40 years	13.3%	50%	0%
40 years to 50 years	2.3%	100%	0%
50 years to 60 years	0.00%	100%	0%
60 years to 70 years	0.00%	100%	0%
Maximum principal funds invested *>364 days*	Nil	Nil	

4. The Main Prudential Indicators and Compliance with Limits

4.1 The Council is required by the Prudential Code to report the actual prudential indicators after the year end.

4.2 Capital Expenditure and its Financing
This forms one of the required prudential indicators and shows total capital expenditure for the year and how this was financed. The reduction in total capital expenditure between revised estimate and actual as noted below in Table 3 is due to expenditure which slipped from 2013/14 into the 2014/15 capital programme, together with resources. The indicators for 2014/15 will be revised in line with this.

Table 3

	2013/14 Actual	**2013/14 Revised Estimate**
Total capital expenditure	£60.371m	£78.027m
Resourced by:		
Capital receipts and grants	£16.557m	£23.297m
Revenue	£4.868m	£6.812m
Capital expenditure - additional need to borrow	**£38.946m**	**£47.918m**

4.3 Net Borrowing and the Capital Financing Requirement (CFR)
In order to ensure that borrowing levels are prudent, over the medium term the Council's external borrowing, net of investments, must only be used for capital purposes. Net borrowing should not therefore, except in the short term, exceed the CFR for 2013/14 plus the expected changes to the CFR over 2014/15 and 2015/16.

4.5 The Executive Director of Corporate Services reports that the Council has complied with the requirement to keep adjusted net borrowing below the CFR in 2013/14 as noted below in Table 4.

Table 4

	2013/14 Actual	**2013/14 Revised Indicator**
Net borrowing position per Table1	£250.481m	£249.804m
PPP long term liability	£89.753m	£90.242m
Adjusted net borrowing position	£340.234m	£340.046m
Capital Financing Requirement	£346.168m	£355.723m

4.6 The adjusted net borrowing position is in line with the revised 2013/14 indicator due to action taken to reduce the level to which the Council was underborrowed at the year end.

4.7 **The Authorised Limit**
The Authorised Limit is the "Affordable Borrowing Limit" required by Section 35 of the Local Government in Scotland Act 2003. The Council does not have the power to borrow above this level. The information in Table 5 demonstrates that during 2013/14 the Council has maintained gross borrowing within its Authorised Limit.

4.8 **The Operational Boundary**
The Operational Boundary is the borrowing position that the Council expects to work around during the year, and periods where the actual position is either below or over the Boundary is acceptable subject to the Authorised Limit not being breached.

4.9 **Incremental Impact of capital investment decisions**
This indicator identifies the trend of the proposed changes in the capital programmes compared to existing commitments and current plans, measured against Band D council tax and weekly housing rents.

4.10 **Actual financing costs as a proportion of net revenue stream**
This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs, net of investment income) against the net revenue stream. The cost of capital is described as loan charges within the revenue budgets.

4.11 The General Services indicator for the incremental impact of capital investment decisions has increased from the estimated position based on the initial 10 year capital plan as approved by Council in February 2013. This is due to application of previously agreed prudential borrowing in the capital programme, grants and contributions received being less than anticipated.and the timing of anticipated capital receipts.

Table 5

	2013/14	
Revised Indicator - Authorised Limit	£408.056m	
Revised Indicator - Operational Boundary	£374.051m	
Maximum gross borrowing position during 2013/14	£347.687m	
Minimum gross borrowing position during 2013/14	£302.998m	
	Estimated	**Actual**
Incremental Impact of capital investment decisions:		
Council Tax (excluding year-end flexibility)	£9.12	£24.81
Rent	£2.58	£2.51
Financing costs as a proportion of net revenue stream:		
Housing	36.24%	36.75%
Non housing	6.95%	7.01%

5. Summary of the Economic Factors affecting the Strategy over 2013/14

5.1 Economic Background for 2013/14

5.1.1 Interest Rates

The original expectation for 2013/14 was that Bank Rate would not rise during the year and for it only to start gently rising from quarter 1 2015. This forecast rise has now been pushed back to a start in quarter 3 2015. Economic growth (GDP) in the UK was virtually flat during 2012/13 but surged strongly during the year. Consequently there was no additional quantitative easing during 2013/14 and Bank Rate ended the year unchanged at 0.5% for the fifth successive year. While CPI inflation had remained stubbornly high and substantially above the 2% target during 2012, by January 2014 it had, at last, fallen below the target rate to 1.9% and then fell further to 1.7% in February. It is also expected to remain slightly below the target rate for most of the two years ahead.

5.1.2 Deposit Rates

The Funding for Lending Scheme, announced in July 2012, resulted in a flood of cheap credit being made available to banks which then resulted in money market investment rates falling drastically in the second half of that year and continuing into 2013/14. That part of the Scheme which supported the provision of credit for mortgages was terminated in the first quarter of 2014 as concerns rose over resurging house prices.

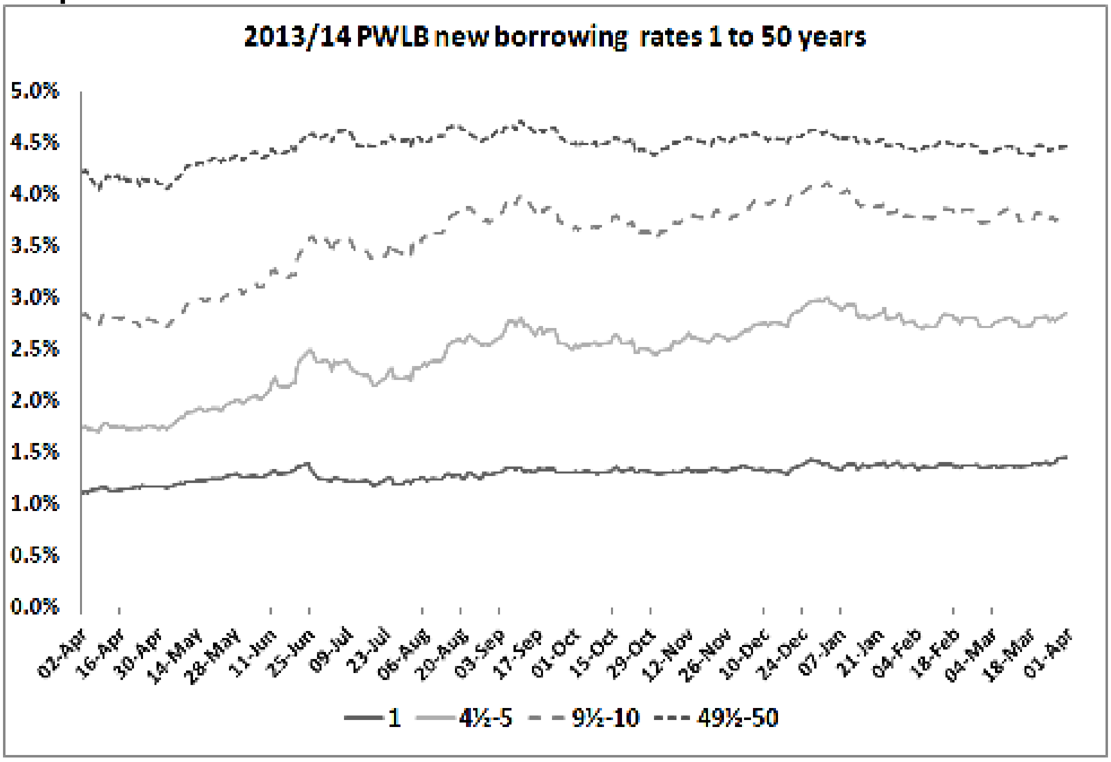
5.1.3 Fiscal Policy and the EU

The UK coalition Government maintained its tight fiscal policy stance but recent strong economic growth has led to a cumulative, (in the Autumn Statement and the March Budget), reduction in the forecasts for total borrowing, of £97bn over the next five years, culminating in a £5bn surplus in 2018-19.

The EU sovereign debt crisis subsided during the year and confidence in the ability of the Eurozone to remain intact increased substantially. Perceptions of counterparty risk improved after the ECB statement in July 2012 that it would do “whatever it takes” to support struggling Eurozone countries; this led to a return of confidence in its banking system which has continued into 2013/14 and led to a move away from only very short term investing. However, this is not to say that the problems of the Eurozone, or its banks, have ended as the zone faces the likelihood of weak growth over the next few years at a time when the total size of government debt for some nations is likely to continue rising. Upcoming stress tests of Eurozone banks could also reveal some areas of concern.

5.1.4 PWLB borrowing rates - the graphs and table for PWLB certainty maturity rates below, and in appendix 3, show, for a selection of maturity periods, the high and low points in rates, the average rates, spreads and individual rates at the start and the end of the financial year.

Graph 1



6. Treasury Activity during 2013/14

6.1 **Borrowing** – The Council raised new long term loans of £34.9m and new short term loans of £39.0m during 2013/14 for the replacement of naturally maturing debt and to finance the Council's capital programme.

6.2 **Rescheduling** – No debt rescheduling was carried out in 2013/14.

6.3 **Repayment** – The Council repaid naturally maturing debt of £36.9m.

6.4 **Summary of Debt Transactions** – The overall position of the debt activity resulted in the average interest rate at 31 March year on year falling slightly to 4.22%.

6.5 **Investment Policy –** The Scottish Government issued The Local Government Investments (Scotland) Regulations 2010 on 1 April 2010.

6.6 The regulations applied from 1 April 2010 and the Council's policy was included in the annual treasury strategy approved by Council on 30 March

2013. The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

6.7 The Council's investments increased from £2.244m at the beginning of the year to £4.652m at the end of the year with an average balance of £9.614m and received an average return of 0.56% over the year.

6.8 The Economic Background for 2013/14 (see 5.1 above) set out the fragility and inconsistency of economic conditions during this period. As a result, available interest rates remained low impacting adversely on investment returns.

7. Performance Indicators set for 2013/14

7.1 Security, liquidity and yield benchmarks were first introduced for 2010/11. Yield benchmarks are currently widely used to assess investment performance.

- **Security** - In the context of benchmarking, assessing security is a very subjective area. Security is currently evidenced by the application of minimum quality criteria to financial institutions that the Council may choose to invest in, primarily through the use of credit ratings supplied by the three main credit rating agencies (Fitch, Moody's and Standard & Poors). The Council has benchmarked security risk by assessing the historical likelihood of default for investments placed with any institution with a long term credit rating of A- (this is the minimum long term credit rating used in the Council's investment strategy). The Council's maximum security risk is that 0.09% of investments placed with financial institutions could theoretically default based on global historical data. The Executive Director of Corporate Services can report that all investments within the Council's portfolio were repaid on their due dates with no defaults of the principal sums recorded.

- **Liquidity** – As required by the CIPFA Treasury Management Code of Practice the Council has stated that it will "ensure that it has adequate, though not excessive, cash resources, borrowing arrangements, overdrafts or standby facilities to enable it at all times to have the level of funds available to it which are necessary for the achievement of its business/service objectives". In respect to liquidity as defined above the Executive Director of Corporate Services can report that liquidity arrangements during the year were maintained in line with the facilities and benchmarks previously set by the Council as follows:

    - Bank overdraft - £1.000m
    - Liquid short term deposits of at least £5.000m available on an overnight basis.

- **Yield** – The Executive Director of Corporate Services can report that investment return averaged 0.56% which is a year on year decrease of 0.03% with an average external investment period of 20 days. Table 6 illustrates that the average return of 0.56% was greater than the local measures of yield investment benchmarks approved in March 2012.

Table 6

Benchmark	Benchmark Return	Average Return
Internal returns above the 7 day LIBID rate	0.34%	0.56%
Internal returns above the 1 month LIBID rate	0.36%	0.56%
Internal returns above the Council investment account	0.50%	0.56%

8. Risk and Performance

8.1 Other than the temporary breach in the debt maturity indicator the Council has complied with all relevant statutory and regulatory requirements which require the Council to identify and, where possible, quantify the levels of risk associated with its treasury management activities. In particular its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach.

8.2 The Council is aware of the risks of passive management of the treasury portfolio and, with the support of the Council's treasury advisers, has proactively managed its treasury position within the current economic climate taking advantage of lower interest rates where it is deemed appropriate. The Council has complied with its internal and external procedural requirements. There is little risk of volatility of costs in the current debt portfolio as the interest rates are predominantly fixed, with the majority of debt comprised of long-term loans.

8.3 Shorter-term rates and likely future movements in these rates predominantly determine the Council's investment return. These returns can therefore be volatile and, whilst the risk of loss of principal is minimised through the annual investment strategy, accurately forecasting future returns can be difficult.