WARWICK DISTRICT COUNCIL	**Finance & Audit Scrutiny Committee - 29 July 2014**	**Agenda Item No.** **4**

Title	2013/14 Annual Treasury Management Report
For further information about this report please contact	Karen Allison, Assistant Accountant 01926 456334 e mail: Karen.allison@warwickdc.gov.uk
Wards of the District directly affected	None
Is the report private and confidential and not for publication by virtue of a paragraph of schedule 12A of the Local Government Act 1972, following the Local Government (Access to Information) (Variation) Order 2006	No
Date and meeting when issue was last considered and relevant minute number	N/A
Background Papers	Treasury Management Annual Strategy Plan 2013/2014 Various documents from Capita Asset Services - Treasury Solutions

Contrary to the policy framework:	No
Contrary to the budgetary framework:	No
Key Decision?	No
Included within the Forward Plan? (If yes include reference number)	No
Equality & Sustainability Impact Assessment Undertaken	No – not relevant

Officer/Councillor Approval		
Officer Approval	**Date**	**Name**
Chief Executive	11.07.2014	Chris Elliott
Head of Service	N/A	
CMT	N/A	
Section 151 Officer	14.07.2014	Mike Snow
Monitoring Officer	N/A	
Finance	17.07.2014	Roger Wyton
Portfolio Holder(s)	N/A	
Consultation & Community Engagement		
None		
Final Decision?	Yes	
Suggested next steps (if not final decision please set out below)		
N/A		

1. SUMMARY

1.1. The Council is required to report upon its 2013/14 Treasury Management performance by 30th September. This report therefore details and reviews the Council's performance for the whole of 2013/14 and is attached as Appendix A.

1.2 Consideration of the Council's Treasury Management activities is within the remit of the Finance and Audit Scrutiny Committee hence, it is appropriate to report the Council's annual performance direct to this Committee.

1.3 The report follows the format used in the Treasury Management Strategy Plan presented to the Executive on 13th February 2013 and comments, where appropriate, on the Council's actual performance against what was forecast in the Strategy Plan. The Council also has to comment upon its performance against its Annual Investment Strategy for the year.

2. RECOMMENDATION

2.1 That the Members of the Finance and Audit Scrutiny Committee note the contents of this report.

3. REASONS FOR THE RECOMMENDATION

3.1 The 2013/14 Treasury Management Strategy and the Council's Treasury Management Practices, in accordance with the Code of Practice for Treasury Management, require that the Treasury Management function reports upon its activities during the year by no later than 30th September in the year after that which is being reported upon.

4. POLICY FRAMEWORK

4.1 Treasury Management will support the Council in achieving its aims as set out in "Fit for the Future".

5. BUDGETARY FRAMEWORK

5.1 Treasury Management has a potentially significant impact on the Council's budget through its ability to maximise its investment interest income and minimise borrowing interest payable. The Council is reliant upon interest received to help fund the services it provides. As detailed in paragraph 11.9, the net interest received by the General Fund for 2013/14 was £242,387 against a revised estimate of £233,707 and original of £205,500.

6. ALTERNATIVE OPTION CONSIDERED

6.1 None.

APPENDIX A

2013/14 ANNUAL TREASURY MANAGEMENT REPORT

7. REVIEW OF THE INTEREST RATE ENVIRONMENT.

7.1 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. Our Treasury consultants, Capita Asset Services, now forecast that the first rise of 0.25% will be in quarter 2 2016 and will be followed by similar increases of 0.25% per quarter although recent comments by the Governor of the Bank of England suggest that the first rise could occur earlier than quarter 2 of 2016. Economic growth (GDP) in the UK was virtually flat during 2012/13 but surged strongly during 2013/14. 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.

7.2 With regard to 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 2012/13 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.

7.3 Gilt yields which in turn determine PWLB lending rates were on a sharply rising trend during 2013 but volatility returned in the first quarter of 2014 as various fears sparked a flight to quality.

7.4 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.

8. CAPITAL EXPENDITURE AND FINANCING

8.1 The Council's capital programme for 2013/14 amounted to £10,161,659 and was financed in the following manner:-

	2013/14 Actual		Strategy Report
	£		£
Prudential Borrowing	0		0
Capital Receipts	1,598,642		2,270,800
Revenue and Reserves	6,647,687		13,950,300
External Contributions and Grants	1,915,330		3,036,900
Total	**10,161,659**		**19,258,000**

9. BORROWING

9.1 The Council managed its cash flow during the year such as to not require any temporary borrowing.

9.2 The Council incurred £4,765,564 interest on its external borrowing portfolio of £136.157 million in 2013/14 which was charged entirely to the HRA as it related to the Self Financing borrowing incurred in 2011/12.

10. TREASURY LIMITS AND PRUDENTIAL INDICATORS

10.1 The Prudential Capital Finance system was introduced on 1st April 2004. The system is regulated by a number of Prudential Indicators, a number of which are relevant for treasury management purposes and are included in the Annual Strategy Report. The table below shows the outturn against those quoted in the Strategy Report:-

	2013/14 Out-turn		2013/14 Strategy Report
	£		£
Authorised Limit for External Debt			
Borrowing	162,050,000		162,100,000
Other Long term Liabilities	1,092,000		1,092,000
Total	**163,142,000**		**163,192,000**
Operational Boundary for External Debt			
Borrowing	151,050,000		151,100,000
Other Long term Liabilities	92,000		90,000
Total	**151,142,000**		151,190,000
Capital Financing Requirement			
General Fund	-£1,326,896		-£1,326,896
Housing Revenue Account	£135,786,796		135,786,796
Overall	**£134,459,900**		**£134,459,900**
Incremental Impact on Council Tax / Housing Rents			
Council Tax	£1.97		£1.31
Housing Rent	£0.00		£0.00

10.2 There are the following indicators relating to borrowing:-

<u>Upper limit to fixed interest rate and variable interest rate exposures</u>

Strategy Report - Upper Limit Fixed Rate = 100%
Actual – Upper Limit Fixed Rate = 100%

Strategy Report - Upper Limit Variable Rate = 30%
Actual – Upper Limit Variable Rate = 30%

<u>Upper and lower limits respectively for the maturity structure of borrowing</u>

Period	**Upper**	**Lower**
Under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%

In both cases the indicators were complied with as the only borrowing outstanding at the year end was the £136.157m PWLB debt in respect of the HRA Self Financing Payment. This debt is all fixed rate maturing from years 41 to 50 of the Business Plan and therefore this is within both indicators shown above.

10.3 The final indicator monitors the amount invested for periods longer than 364 days which in 2013/14 was set at 40% of the investment portfolio subject to a maximum of £9 million at any one time. During 2013/14 the Council entered into two investments for periods in excess of 364 days totalling £7 million which was 13% of the investment portfolio. Therefore the indicator was complied with.

11. <u>ANNUAL INVESTMENT STRATEGY AND INVESTMENT PERFORMANCE</u>

11.1 The ODPM guidance on local government investments require the production of an Annual Investment Strategy which amongst other things outline the investment vehicles which could be used by the Council and separate them off into Specified and Non Specified investments. The 2013/14 Annual Investment Strategy was approved by the Council in February 2013 and can be accessed by clicking on the link in paragraph 1.3.

11.2 During the year the in house investments were invested in the Money Markets and Money Market Funds.

11.3 The in house function has invested the Council's core cash funds in both fixed term Money Market deposits and Certificates of Deposit (CD's). The table below illustrates the performance for the year of the in house function for each category normally invested in (please refer to 2nd half year report for a breakdown by half year):-

(It should be noted that this table reflects investments placed in the year and does not take into account investments that were placed during 2012/13 which matured during 2013/14 and therefore the total interest for 2013/14 does not compare with that shown in paragraph 5.1 which is also net of the amount credited to the Housing Revenue Account in respect of interest earnt on its balances).

Money Market Investments:

Period	Investment Return (Annualised)	LIBID Benchmark (Annualised)	Out/(Under) performance
Up to 7 days			
Annual Performance	No investments made in year		
Over 7 days & Up to 3 Months			
Annual Performance	0.49%	0.44%	+0.05%
Annual Interest	£9,220	£8,028	+£1,192
Over 3 Months & Up to 6 Months			
Annual Performance	0.52%	0.54%	-0.02%
Annual Interest	£14,638	£15,251	-£613
Over 6 Months to 364 days			
Annual Performance	0.82%	0.82%	+0.00%
Annual Interest	£149,393	£149,809	-£416
365 days and over			
Annual Performance	0.99%	0.98%	+0.01%
Annual Interest	£135,585	£133,574	+£2,011
Total Annual Interest – All categories.	**£308,836**	**£306,662**	**+£2,174**

11.4 Due to Money Market Funds outperforming the Up to 7 Day area of the Money Markets, this category was not used in 2013/14 for cash flow driven investments. The first half year saw an inline performance of the '3 to 6 months' period and a 0.21% outperformance of the 'over 6 months to 364 days 'period when compared to the LIBID benchmark. During the second half year a three month building society investment contributed to a 0.05% outperformance whilst '365days and over' produced a marginal outperformance of 0.01% when compared to the LIBID benchmark.

11.5 The in house function utilised the AAA rated Invesco AIM, Deutsche, Federated Prime Rate, Ignis and Goldman Sachs Money Market Funds to assist in managing its short term liquidity needs. The table below illustrates the performance for the full year of the five funds:

Money Market Funds:

Fund	Investment Return (Annualised)	LIBID Benchmark (Annualised)	Out/(Under) Performance
Deutsche			
Annual Performance	**0.37%**	**0.41%**	**-0.04%**
Annual Interest	**£546**	**£608**	**-£62**
Goldman Sachs			
Annual Performance	**0.37%**	**0.41%**	**-0.04%**
Annual Interest	**£3,052**	**£3,466**	**-£414**
Invesco Aim			
Annual Performance	**0.32%**	**0.41%**	**-0.09%**
Annual Interest	**£135**	**£177**	**-£42**
Federated Prime Rate			
Annual Performance	**0.47%**	**0.41%**	**+0.06%**
Annual Interest	**£42,267**	**£37,466**	**+£4,801**
Ignis			
Annual Performance	**0.43%**	**0.41%**	**+0.02%**
Annual Interest	**£35,557**	**£34,180**	**+£1,377**
TOTAL INTEREST FOR YEAR	**£81,557**	**£75,897**	**+£5,660**

11.6 The Up to 7 Days LIBID rate is the benchmark in this instance and it can be seen that three of the funds made returns just short of the benchmark. The policy during 2013/14 was to maximise the use of the 2 higher performing MMF's and as such, at times it was necessary to place funds in the lower performing funds as a result of the counterparty limits on the higher performing funds being reached. Of the three lower performing funds, it should be noted that the Invesco AIM fund was little used during the year with the majority of investments being placed in the Goldman Sachs fund which marginally outperformed the Deutsche fund. Of the two funds that made returns in excess of the LIBID benchmark, the Federated Prime Rate Money Market Fund performed particularly well compared to the others and this is as a result of it having a slightly longer weighted average maturity (WAM) than the other funds. This perceived greater risk thus yielding a higher return. However, it must be stressed that all Money Market Funds have to adhere to a very strict credit rating criteria and therefore funds with slightly more risk in them are still very safe.

11.7 The Council has access to two Bank Rate tracking Business Reserve Accounts with Santander (previously Abbey National) and Lloyds Banking Group (previously Bank of Scotland). Due to Santander been taken off our lending list and also due to the low Bank Rate during the year and as better returns could be obtained from the Money Market Funds these reserve accounts were not used during 2013/14.

11.8 During the year, the Council opened two new Call accounts with HSBC and Svenska Handelsbanken. These accounts offer instant access linked to attractive interest rates, particularly in respect of the Svenska Handelsbanken account and the opportunity was taken to invest some of the Council's maturing 364 day core investments into this account as the interest rate being offered was in excess of that available for fixed term 364 day deposits with counterparties such as other Councils. Svenska Handelsbanken are a highly rated Swedish bank so additional return has been secured for little reduction in counterparty security. The HSBC Business Deposit account has a tiered interest rate structure and for balances of £2m and above paid 0.40% which is slightly more than the three lower performing Money Market Funds and as result of this, funds which would normally have been invested in the likes of the Deutsche or Invesco Money Market Funds were diverted to the HSBC Business Deposit Account instead thus providing a small pick-up in return for little reduction in security as HSBC has a high credit rating. In the first half year the HSBC Business Deposit Account underperformed against the LIBID benchmark rate but during the second half year, with the introduction of the new Svenska Handelsbanken account, the Council outperformed the benchmark as can be seen in the table overleaf:

Call Accounts:

Fund	Investment Return (Annualised)	LIBID Benchmark (Annualised)	Out/(Under) Performance
HSBC Business Deposit a/c			
Annual Performance	0.39%	0.41%	-0.02%
Annual Interest	£11,517	£12,190	-£673
Svenska Handelsbanken			
Annual Performance	0.54%	0.41%	+0.13%
Annual Interest	£5,729	£4,376	+£1,353
TOTAL INTEREST FOR YEAR	**£17,246**	**£16,566**	**+£680**

11.9 In paragraph 5.1 of the Annual Investment Strategy, the Council anticipated that it would have an average investment balance in the region of £48m during 2013/2014. The actual was £52.4m, the increase being partly accounted for by slippage in the capital programme leading to higher than expected balances in reserves, unused capital receipts, increased Council House sales resulting from the change in Right To Buy discounts which are now more generous than before and from increased cash flows during the year. In addition the impact of the Housing Self-Financing regime has resulted in increased investment balances both of a cash flow nature and also as a result of the enhanced Capital Programme envisaged by the business plan not yet commencing. As an illustration of this the balance on the Housing Capital Investment Reserve has increased by £4.8 million at the end of the year. The investment strategy of this cash would not have been any different had we known about the "additional" £4.8m. Paragraph 10.3 makes reference to a 40% maximum long term investments holding. The average investment balance in 2013/14 was £53.4m of which a maximum of £9m could have been invested for more than 364 days at any one time. In actual fact £7m was invested for more than 364 days which was 13% of the portfolio and therefore the Council did not exceed the 40% limit on longer term investments nor did it contravene the requirement to hold at least 60% of its portfolio in short term (364 days or less) investments. A comparison between 2012/13 actual, 2013/14 revised and 2013/14 actual in terms of in house investment interest returns and interest rates is shown in the table below:-

In House Investment Returns:

Year	Interest Received (£)	Interest Rate Achieved %
2012/13 actual	447,354	0.95
2013/14 revised	371,507	0.70
2013/14 actual	368,931	0.69

In the Annual Investment Strategy approved in February 2013, it was anticipated that the in house portfolio would achieve a 0.64% return for 2013/14. The actual rate was 0.69% which is closely in line with the 2013/14 revised.

11.10 The table below compares the actual total interest received by the Council with what was expected when the original and revised estimates were calculated and also the 2012/13 actual:-

	Credited to General Fund	**Credited to Housing Revenue Account**	**Total Investment Interest Earned**
	£	**£**	**£**
2012/13 Actual	335,754	115,600	451,354
2013/14 Original	205,500	117,900	323,400
2013/14 Revised	233,707	137,800	371,507
2013/14 Actual	242,387	131,700	374,087

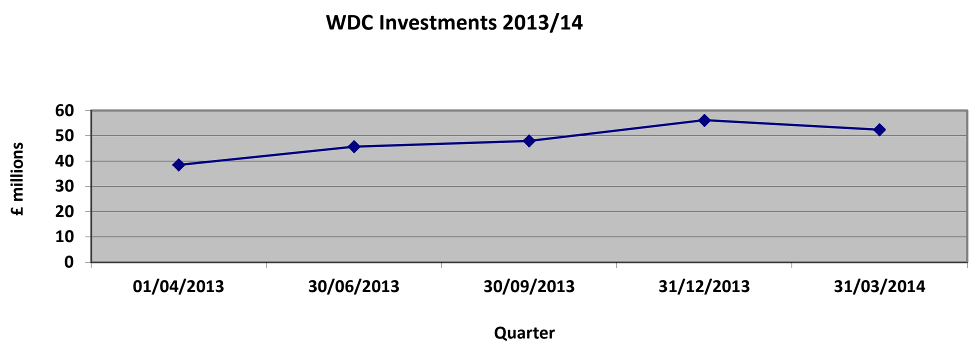
It should be borne in mind that the 2012/13 and 2013/14 actual figures in the tables in 11.8 and 11.9 are not directly comparable as the table in 11.8 relates only to investments made whilst the figures in 11.9 include interest received from other sources i.e. car loans, long term investments e.g. war stock.

11.11 An analysis of the overall investments of the Council as at 31st March 2014 is shown in the table below, with the previous year's figures shown for comparison purposes:

IN HOUSE	**31st March 2014**	**31st March 2013**
TYPE OF INVESTMENT	**£**	**£**
Money Markets inc. CD's	34,010,804	26,000,000
Call Accounts	5,739,000	0
Money Market Funds	12,671,000	12,488,000
Total	**52,420,804**	**38,488,000**

It should be noted that the Money Markets figure at 31st March 2014 includes £10,804 capital appreciation as a result of the price for each CD at 31st March being greater than that which was paid when the CD was originally purchased. However, these CD's were purchased on a "buy to hold" basis and thus this capital appreciation will not be realised when the CD's mature as they will be redeemed at "par" i.e. the original price.

11.12 The graph overleaf shows how the total of the Council's investments varies through the year according to its cash flows. It illustrates that during the period April to December the Council's investments grows as cash flows in from such sources as Council Tax & NNDR and then from January onwards how the investments decline as cash flows out e.g. precepts exceed that coming in although the decline from January onwards this year has not been as marked as in previous years due to the higher investment balances being generated as a result of the comments in paragraph 11.9.



12. BROKERS PERFORMANCE

12.1 The performance of the brokers that WDC uses to place its Money Market investments has been measured against the rates available in the market on the day that the investments were placed in order to ensure that WDC is obtaining a reasonable rate given the size of deposit that WDC normally places. Since the advent of Money Market Funds and other vehicles such as CD's and Call Accounts, the number of investments placed through brokers has much reduced but an analysis shows that the brokers in general either achieved or exceeded the going rate for the day other than on some occasions when the rates achieved fell below the market rates as we invested more in Local Authorities and highly rated banks for added security to our portfolio.

13. PERFORMANCE MEASUREMENT

13.1 In addition to the in house local benchmarks referred to in the tables in paragraphs 11.3 and 11.5 the Council participates in the Capita Asset Services Investment Benchmarking Club which benchmarks not only investment returns but also the maturity and credit risk inherent in the portfolio. The Council is part of a local group which consists of District and County Councils and our performance over the past year is reflected in the tables overleaf:-

Table A Weighted Average Rate of Return (WARoR)

	WDC WARoR %	Local Group WARoR %	Capita Asset Services Model WARoR %
June Quarter	0.84	0.76	0.93
September Quarter	0.63	0.60	0.77
December Quarter	0.65	0.61	0.59
March Quarter	0.67	0.64	0.68
Average for Year	**0.70**	**0.65**	**0.74**

(n.b. it should be noted that the average interest rate for the year is not directly comparable to that quoted in paragraph 11.8 as that contains the effect of investments made in 2012/13 and maturing in 2013/14 whereas the rate in table A relates to 2013/14 investments only.)

13.2 It can be seen that the Council's average return was largely in line with Capita Asset Services' model portfolio rate of return based on the risk in our portfolio. The September quarter underperformed mainly due to an assumption within the benchmarking model with which we are compared, that we should have obtained higher interest rates for some of the investments made in the quarter than we actually did. The rates obtained were dictated by the market conditions on the day. The Council's average for the year outperformed against the local group's rate of return mainly due to the local group, particularly the County Councils, placing some investments with building societies and a significant amount of investments in short term or overnight deposits with the Government which offered inferior interest rates when compared to vehicles offering comparable AAA rated security such as Money Market Funds.

Table B Weighted Average Credit Risk

	WDC	Local Group
June Quarter	1.7	2.7
September Quarter	1.8	3.0
December Quarter	1.5	3.7
March Quarter	2.5	2.7
Average for Year	**1.9**	**3.0**

13.3 This benchmark measures the average credit risk in the portfolio according to the institutions invested in and corresponds to the duration limits in Capita Asset Services' suggested credit methodology using a sliding scale of 1 to 7 where 1 indicates the least risk of default. The above table shows that this Council's credit risk during the year has a level below that of the local group and this is accounted for by our use of Local Authority investments and CD's from strongly rated counterparties and which consequently have a lower credit risk.

13.4 The Council's credit risk for the year was limited by moving away from investments with unrated Building Societies (only one investment was made during the whole financial year) and into Call Accounts with highly rated banks. Since Capita Asset Services' advice in January 2013 to invest in longer dated investments with stronger rated counterparties, the Council has invested £7m long term with Local Authorities which has also lowered the credit risk in the portfolio.

14. THE EURO

14.1 The Treasury Management Strategy Plan requires the Treasury Management function to keep up to date with matters relating to the UK's possible entry into the Euro. The Eurozone 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. Also upcoming stress tests of Eurozone banks could also reveal some areas of concern. Such events together with a potential referendum on the UK's membership of the EC make it extremely unlikely that the UK will consider joining the Eurozone for the foreseeable future.

15. EXTERNAL TREASURY MANAGEMENT ADVISERS

15.1 Capita Asset Services, formerly known as Sector Treasury Services Ltd. continues to provide our Treasury Management Advisory service. The contract is due for renewal in January 2015 and a full tender evaluation will be carried out.

16. OTHER ISSUES

16.1 The Council has entered into a joint venture with Waterloo Housing Association in which Council land will be sold on a deferred basis to the Housing Association in order to provide resources for additional social housing. The first parcel of land, the former Kingsway Community Centre, was sold during 2012/13 to Waterloo HA which resulted in a deferred capital receipt of £224,252. During 2013/14, further sales to Waterloo of WDC land comprising two garage sites at Bourton Drive and Henley Road were agreed although the actual sales will not take place until 2014/15. Again, these sales will result in deferred capital receipts which will not be available for use until the final instalment payment is received some years in the future.