Appendix 1 to Report 354/14

Angus Council - Treasury Management Annual Report 2013/14

1. Introduction

The Council is required through regulations issued under the Local Government in Scotland Act 2003 to produce an annual treasury report reviewing treasury management activities and prudential and treasury indicators following the end of each financial year. This report meets the requirements of both the Chartered Institute of Public Finance and Accountancy Code of Practice on Treasury Management (the Code) and the Chartered Institute of Public Finance and Accountancy Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

During 2013/14 the minimum reporting requirements were that the full Council should receive the following reports:

- an annual treasury strategy in advance of the year (report 120/13 refers);
- a mid year treasury management review (report 569/13 refers);
- an annual report following the year end describing the activity compared to the strategy (this report).

Recent changes in the regulatory environment place a much greater onus on members for the review and scrutiny of treasury management policy and activities. This report is important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members.

The report also fulfils the requirement under the Code that relevant treasury management reports are considered and if necessary commented upon by the Scrutiny and Audit Committee.

This annual report contains details of the Council's borrowing and investment activities during 2013/14 including;

- borrowing outturn for 2013/14 (Section 3)
- borrowing strategy for 2013/14 (3.1);
- debt rescheduling (3.5);
- investment outturn for 2013/14 (Section 4);
- investment strategy for 2013/14 (4.2);
- variations from agreed policies and practices (Section 5);
- compliance with treasury and prudential limits (Section 6).

2. Treasury Management Performance Overview for 2013/14

2.1 Borrowing and investment position as at 31 March 2014

The Council's debt and investment position is organised by the treasury management team in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through member reporting detailed in the introduction above, and through officer activity detailed in the Council's Treasury Management Practices (report 120/13 provides further information in respect of the Council's Treasury Management Practices).

The Council's treasury position as at 31 March 2014 is shown in Table 1 below. The treasury position as at 31 March 2013 is also shown for comparative purposes.

Table 1 – Borrowing and Investment Position

External Debt	Total Principal as at 31 March 2014	Total Principal as at 31 March 2013
Fixed Rate Borrowing PWLB*	£133.480m	£136.721m
Fixed Rate Borrowing Market	£30.000m	£30.000m
Fixed Rate Total	£163.480m	£167.721m
Variable Rate Borrowing PWLB	Nil	Nil
Borrowing	Nil	Nil
Market	Nil	Nil
Total External Debt	**£163.480m**	**£167.721m**
Investments	(£39.5m)	(£45.391m)
Total Net External Debt	£123.980m	£122.330m

(*PWLB represents the Public Works Loans Board)

In addition to its net external debt of £123.980m the Council also administers a number of other funds (for example, Charitable Funds and Common Good) and maintains a number of internal revenue balances (for example, Capital Fund, General Fund Balance, Housing Revenue Account Balance and Renewal and Repair Funds).

It should be noted that the foregoing includes debt which the Council administers for the former Tayside Police Joint Board and will continue to administer on behalf of Police Scotland. The amount of capital debt outstanding at 31 March 2014 for the former Tayside Police Joint Board was £7,827,000.

2.2 Treasury management 2013/14 performance summary

The financial year 2013/14 continued the challenging investment environment of previous years, namely low investment returns, although levels of counterparty risk subsided somewhat. The original expectation for 2013/14 was that the Bank Rate would not rise during the year but would start rising gently from quarter 3 2015. This expectation has however been brought forward to quarter 1 2015. 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 the Bank Rate ended the year unchanged at 0.5% for the fifth successive year.

This challenging economic environment and historically low interest rates again required proactive management of debt and investment exposure to keep the loans fund interest rate low and to protect the Council's investments.

Despite the continuing turbulence in the money market during the 2013/14 financial year, the Council has performed relatively well by taking the opportunity of securing long term investment interest rates from suitable counterparties at times when their interest rates on offer were relatively high. This resulted in an investment rate of return of 0.90% which is 0.51% above the 3 month London Interbank Bid rate benchmark return of 0.39%.

However, depending on the level and timing of the Council's available cash balances and market investment interest rates it may not always be possible to outperform the benchmark rate of return by such a margin.

The Angus Council loans fund interest rate used to calculate the amount of interest payable on outstanding debt at the end of 2013/14 is detailed in Table 2 below:

Table 2 – Loans Fund Interest Rate

Year	Budget (%)	Actual (%)
2013/14	4.85	**4.73**
2012/13	4.75	4.53

It can be seen from Table 2 above the Council's consolidated interest rate for 2013/14 was 0.12% lower than the budget and 0.20% higher than the previous year's interest rate. A number of factors affect the interest rate including the interest rates payable on new / refinanced external borrowing, the level of return on short term investments, the existing total Loans Fund advances outstanding and the level of new Loans Fund advances associated with in-year capital spend levels. The increase in rate between 2012/13 and 2013/14 primarily reflects significantly lower investment returns and reduced levels of Loans Fund advances.

The Council, of course, incurs expenses in administering and managing the loans fund and the rate required to recover such expenses from borrowing accounts in 2013/14 was 0.07%. For comparison purposes the expenses rate in 2012/13 was also 0.07%.

The loans fund comparative rates for 2013/14 for all other Scottish Authorities have yet to be published, however the 2012/13 loans pool rate for Angus Council was 4.53% which was very much in line with the average of 4.52% for Scottish Local Authorities (excluding Orkney and Shetland) and it is thought likely that the 2013/14 position as outlined will be broadly in line with the Scottish Average rate when published.

It should be noted that the treasury management team is assisted by the Council's treasury management advisers (Capita Asset Services) in undertaking treasury management activities.

In summary as a result of sound treasury management activity, the Council was able to meet all its financial obligations and cashflow requirements throughout the financial year without encountering any liquidity problems. Additionally, a higher than budgeted return on investments was delivered in volatile and challenging economic conditions and in compliance with the treasury management policies and strategies set by Members.

The council also achieved a lower than budgeted rate of interest applied to outstanding debt, although this is not solely influenced by treasury management activity as highlighted after Table 2 above (for example - levels of capital spend).

3. Borrowing outturn for 2013/14

3.1 Borrowing Strategy for 2013/14

The Council's strategy for borrowing in 2013/14 (report 120/13) was to be as flexible as possible, within the constraints of the Prudential and Treasury Indicators, to ensure that borrowing could be undertaken at what was considered to be the most appropriate time (based on the information, intelligence and advice available at the time of making the decision) and for a term suited to the Council's debt maturity profile.

The borrowing strategy for 2013/14 was therefore to borrow either long or short term (to fund the Council's capital financing requirement) when interest rates were at or below the target levels provided by Capita Asset Services.

As part of the above strategy the capital financing requirement based on the anticipated borrowing needs was set at £175.380million. The actual position at the end of the financial year was £174.323million. The end of the year position has mainly arisen as a result of: slippage in capital programmes resulting in the deferral of some long term borrowing; and overall reprofiling of the Council's capital programme.

3.2 Public Works Loans Board interest rates

The highest and lowest P W L B interest rates available during the financial year 2013/14 for 5, 10, 25 and 50 year terms are detailed in Table 3 below. The rates shown have been amended to reflect the 20 basis point P W L B certainty rate reduction. It will be noted that there was significant movement and volatility in the interest rates available.

Table 3 – PWLB Interest Rates 2013/14

Period	Interest Rate Low Point (%)	Interest Rate High Point (%)
5 years	1.51	2.77
10 years	2.52	3.88
25 years	3.72	4.47
50 years	3.85	4.50

3.3 New external borrowing undertaken in 2013/14

New external borrowing of £3million was undertaken from the P W L B during the period 1 April 2013 to 31 March 2014 reflecting the underlying need to borrow for capital purposes identified from the calculation of the capital financing requirement and the very low interest rates available. The following table details the interest rate and terms at which the new long term P W L B loan was undertaken:

Table 4 – New External Borrowing 2013/14

Date Taken	Amount	Term	Rate (%)
25/04/2013	£3million	50 years	3.89

3.4 Debt repayments

The Council repaid £6.741 million in financial year 2013/14 for P W L B loans that naturally matured. Details of the loans repaid are shown in Table 5 below.

Table 5 – Matured Debt Repaid 2013/14

Start Date	Maturity Date	Amount	Rate (%)
29/05/2009	29/05/2013	£4million	2.36
27/04/1990	30/09/2013	£0.741million	11.875
03/03/2010	03/03/2014	£2milion	2.38
	Total Repaid	**£6.741million**	

3.5 Debt rescheduling

There was no debt rescheduling undertaken in 2013/14.

3.6 Borrowing summary

The new external borrowing originally estimated to be required in 2013/14 was £14.9 million per the 2013/14 Treasury Management Strategy Statement (report 120/13 refers). This figure represented the difference (£8.159 million) between the total estimated external debt for 2012/13 and the estimated 2013/14 Capital Financing Requirement (£167.221million and £175.380million respectively) along with borrowing to replace loans that were due to naturally mature throughout the financial year (£6.741million).

As can be seen from Table 4 above a total of only £3million of new external borrowing was undertaken in the financial year which is £11.9 million below the original estimate of £14.9 million. This was due to a number of factors but the 2 main ones were:-

Lower than expected borrowing requirements to fund the General Fund and Housing capital programmes due to slippage on projects, higher levels of capital receipts than budgeted and additional funding from the revenue budget (CFCR) on the Housing capital programme. In short our need to borrow was reduced/deferred.

Relatively high levels of temporary cash balances available for investment meant there was no urgency to taking new borrowing – given the outlook for interest rates to remain low in the short to medium term and the need to manage counterparty risk on temporary investments the Head of Corporate Improvement and Finance took a prudent view that further additional borrowing was unnecessary in the financial year. The Head of Corporate Improvement & Finance took the view that the cost of new borrowing could be avoided by postponing new borrowing with minimal risk of a large rise in the interest rates the Council could borrow at.

4. Investment outturn for 2013/14

4.1 Investment policy

The Council's investment policy is governed by the Scottish Government Investment Regulations, which were originally implemented as part of the 2010/11 annual investment strategy approved by the Council on 25 March 2010.

The policy sets out the approach for choosing investment categories and counterparties, and is based on credit ratings provided by the three main credit rating agencies supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc.). Members' attention is however also drawn to Section 7 below for developments that need to be considered for future investment policy and strategy.

4.2 Investment strategy for 2013/14

The investment strategy for 2013/14 was for investments to be made with reference to the Council's core cash balance, cash flow requirements and the outlook for short-term interest rates (that is to say - rates for investments up to 12 months).

An internal local investment rate target of 0.75% was set as an investment return based on the interest rates available and expectations for the 2013/14 year at the time of setting the strategy.

The strategy also noted that for its cash flow generated balances, the Council would seek to utilise its business reserve accounts, Money Market Funds and short-dated deposits (overnight to three months) in order to benefit from the compounding of interest whilst still maintaining adequate liquidity to deal with unforeseen needs for cash which might arise during the year.

4.3 Investment rates in 2013/14

The Bank Rate remained at its historic low of 0.5% throughout the year; it has now remained unchanged for five years. Market expectations as to the timing of the start of monetary tightening ended up being advanced slightly to early 2015. The Funding for Lending Scheme resulted in deposit rates remaining depressed during the whole of the year, although the part of the scheme supporting provision of credit for mortgages came to an end in the first quarter of 2014.

The average investment rates available in the money market during the financial year 2013/14 are detailed in Table 6 below.

Table 6 – Average Investment Rates

Overnight	7 Day	1 Month	3 Month	6 Month	1 Year
0.35	0.35	0.36	0.39	0.47	0.76

4.4 Investment performance in 2013/14

In accordance with the Chartered Institute of Public Finance and Accountancy's Code of Practice, it is the Council's priority to ensure the security of capital whilst maintaining liquidity, and thereafter to obtain an appropriate level of return which is consistent with the Council's risk appetite.

The average level of funds available on a daily basis for investment purposes in 2013/14 was £52.100million. These funds were available on a temporary basis, and the level of funds that were available was mainly dependent on the timing of payments, receipts of grants and progress on the capital programme.

A full list of investments held by the Council as at 31 March 2014 is shown in Annex A – Table 1.

The Council's cautious and controlled approach to lending resulted in an average daily investment and rate of return for 2013/14, as shown in Table 7 below:

Table 7 – Investment Return Details

Average Daily Investment Exposure £000	Angus Council Rate of Return %	3 Month Benchmark Return %	Internally set local investment rate target %
52,100	**0.90**	0.39	0.75

The above benchmark represents the uncompounded 3 month London Interbank Bid rate. It can be seen from the above that the Angus Council rate of return is 0.51% higher than the benchmark and 0.15% higher than the internally set local investment rate target of 0.75%.

It should be noted that the credit worthiness of all investment counterparties utilised by Angus Council is monitored on an ongoing basis in conjunction with the Council's treasury adviser, Capita Asset Services.

No institutions in which investments were made had any difficulty in repaying investments and interest in full during the year.

5. Variations from agreed policies and practices

There were no variations from agreed policies or practices during the 2013/14 financial year.

6. Compliance with Treasury and Prudential Limits

It is a statutory duty for the Council to determine and keep under review the "Affordable Borrowing Limits". The Council's approved Prudential and Treasury Indicators are outlined in the 2013/14 Treasury Management Strategy Statement and detailed in the Setting of Prudential Indicators for 2013/14 Budget Process Committee Report (report 110/13 refers).

During financial year 2013/14 the Council operated within the Prudential and Treasury Indicators set out in the Council's 2013/14 Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices. Further information with regards to the Prudential Indicator actuals for 2013/14 is presented in Annex B.

7. Revisions to Treasury Management Strategy 2014/15

Since the Council approval of the Treasury Management Strategy for 2014/15 (report 130a/14 refers) there have been developments that require some revisions to the strategy now and possibly further changes in the future.

7.1 – CAPITA Credit Methodology Changes

Due to changes in the law via the Financial Services (Banking Reform) Act 2013, that will come into force by 2016, it will no longer be legal for a government to bail out a bank in financial difficulties. National regulators will be required to bail-in creditors in order of seniority until their losses reach a defined percentage of the bank's liabilities before any government money can be injected. **This could include Local Authorities**.

In light of these changes, credit rating agencies are reviewing their rating methodologies to take into account the removal of sovereign support to the banks. Fitch have suggested that its Viability Rating will be the same as their Long Term Rating so there is therefore no benefit in monitoring both. Fitch have also begun to assess its Group Support ratings, with an expectation that these will all be lowered to 5 (defined as "A bank for which there is a possibility of external support, but it cannot be relied upon"). As all institutions are likely to drop to this level there is again no benefit in monitoring this rating.

The Treasury Management Strategy currently requires a Counterparty to have (amongst other requirements) the minimum criteria shown in Table 8 below in respect of Fitch credit ratings.

Table 8 – Counterparty Minimum Fitch Rating Criteria

Rating	Minimum Rating
Long Term Rating	A minus
Short Term Rating	F 1
Viability Rating	Triple B
Group Support Rating	1

In light of the above changes there is no value in requiring a minimum Viability or Group Support rating and it is **proposed** that these two criteria are removed from the Counterparty requirements **immediately.**

Advice from the Council's Treasury Management adviser is that there is no need at this stage to review the long and short term rating minimum criteria shown above. This position will however be kept under review and if necessary a further change may be proposed when the 2014/15 mid-year report is presented to Council later in the year.

7.2 – Permitted Investments

The Treasury Management Strategy specifies all types of permitted investments and lending approved by Council. Investments may be made either from cash balances or from borrowing where specific consent to do so is in place. In this regard, Finance Circular 5/2010 recognises that some loans may be made for service reasons and where specific statutory provision exists.

7.2.1 - Third Party Loans

The current strategy is not explicit in permitting the making of loans to third parties. In order to provide flexibility for the Council to consider circumstances where it may be beneficial to make a loan for service reasons, it is **proposed** that the strategy is amended with **immediate effect** to allow this type of investment. Please note that this will only enable third party loans to be given, but it is not approval to give specific loans. These will be considered on a case by case basis in accordance with the Council's Financial Regulations and Schemes of Delegation.

7.2.2 – Lending to Registered Social Landlords (RSLs)

Under current statutory powers the Council is not generally allowed to borrow to on-lend to third parties. The Scottish Government issued Local Government Finance Circular No. 5/2014 on 25 April 2014 giving consent to Councils to borrow to on-lend to Registered Social Landlords (RSLs) or their subsidiaries in order to support new capital investment in affordable homes.

In order for the council to progress any proposals which may come forward in the future to lend to RSLs, it is a requirement of the Government consent that the Treasury Strategy must include such lending as a permitted investment. Therefore, it is **proposed** that the Treasury Strategy is amended with **immediate effect** to include under Non Treasury Investments (Report 130a/14, Appendix A, Annex C, Table 5 refers) an Investment Type of Third Party Loans – RSLs / RSL subsidiaries. This consent does not allow lending to RSLs to assist them with refinancing or restructuring their debt portfolios. The circular also states specific requirements for the approval process by members for any lending to RSL's which would be followed in the event any loans were to applied for.

APPENDIX 1 - ANNEX A

Table 1 - Angus Council External Investments as at 31 March 2014

Counterparty	Investment Type	Interest Rate (%)	Maturity Date	Principal Amount (£)	Group Lending Limit* (£)
Ignis	Money Market Fund	0.38	01/04/14	1,500,000	
Ignis Total	Money Market Fund			**1,500,000**	**10,000,000**
Lloyds Banking Group	Fixed Term Deposit	1.15	14/04/14	5,000,000	
Lloyds Banking Group	Fixed Term Deposit	1.10	11/04/14	500,000	
Lloyds Banking Group	Fixed Term Deposit	0.98	05/09/14	2,000,000	
Lloyds Banking Group	Fixed Term Deposit	0.98	20/11/14	3,000,000	
Lloyds Banking Group	Fixed Term Deposit	0.98	16/12/14	2,500,000	
Lloyds Banking Group	Fixed Term Deposit	0.98	16/02/15	2,000,000	
Lloyds Total	Fixed Term Deposit			**15,000,000**	**15,000,000**
Goldman Sachs IB	Fixed Term Deposit	0.68	19/09/14	3,000,000	
Goldman Sachs IB Total	Fixed Term Deposit			**3,000,000**	**5,000,000**
Royal Bank of Scotland	Bearing Call Account	0.50	01/04/14	3,000,000	
Royal Bank of Scotland	Fixed Term Deposit	0.70	22/05/14	5,000,000	
Royal Bank of Scotland	Fixed Term Deposit	0.69	21/08/14	5,000,000	
Royal Bank of Scotland	Fixed Term Deposit	0.68	18/11/14	2,000,000	
RBS Total	Fixed and Call Account			**15,000,000**	**15,000,000**
Standard Chartered	Certificate of Deposit	0.58	04/06/14	2,500,000	
Standard Chartered	Certificate of Deposit	0.56	15/07/14	2,500,000	
Standard Chartered Total	Certificate of Deposit			**5,000,000**	**10,000,000**
Total Investments				**39,500,000**	

The Group Lending Limit Column – The group lending limits detailed in the above table were the limits based on the credit ratings of each financial institution as at 31 March 2013. The group limits for Ignis and Prime Rate above indicate a £10million limit for each of these counterparties however per the Angus Council Treasury Management Investment Strategy for 2013/14 a maximum of £15million could be placed overall in Money Market Funds but subject to a maximum of £10million in any one fund.

APPENDIX 1 – ANNEX B

Table 1 – Prudential and Treasury Indicators 2013/14

Details	**2013/14 Actual**	**2013/14 Estimate**
	£million	**£million**
<u>Prudential Indicators</u>		
Gross capital expenditure		
General Fund	27.539	24.494
Housing Revenue Account	13.778	15.663
Total Gross capital expenditure	**41.317**	**40.157**
Ratio of financing costs to net revenue stream		
General Fund	9.45%	10.06%
Housing Revenue Account	9.62%	10.57%
Capital Financing Requirement as at 31 March (Excluding Other Long Term Liabilities)	174.323	175.380
Incremental impact of capital investment decisions		
Increase in council tax (band D) per annum	Nil	Nil
Increase in average rent per week	Nil	Nil
<u>Treasury Indicators</u>		
Authorised limit for external debt		
Borrowing	See note below	220.000
Other long term liabilities	See note below	88.453
Total Authorised limit for external debt		**308.453**
Operational boundary for external debt		
Borrowing	See note below	205.000
Other long term liabilities	See note below	88.453
Total Operational boundary for external debt		**293.453**

<u>Note</u> – The authorised limit and operational boundaries were not exceeded in the 2013/14 financial year.

Table 2 – Limits for Investments over 364 days

Details	**Actual @ 31/03/14**	**2013/14 Estimate**
Upper limit for total principal sums invested for over 364 days:		
Year 1	Nil	Unlimited
Year 2	Nil	Unlimited
Year 3 onwards	Nil	Nil

Table 3 – Maturity Structure of Borrowing at 31 March 2014

Maturity structure of borrowing during 2013/14	Actual @ 31/03/14	Upper Limit	Lower Limit
Under 12 months	**4.9%**	**25%**	**0%**
12 months and within 24 months	**3.9%**	**25%**	**0%**
24 months and within 5 years	**11.6%**	**50%**	**0%**
5 years and 10 years	**9.4%**	**50%**	**0%**
10 years and above	**70.2%**	**100%**	**50%**