

Agenda Item No.7 (d)

DERBYSHIRE COUNTY COUNCIL

CABINET

7 July 2015

Report of the Director of Finance

**TREASURY MANAGEMENT
(COUNCIL SERVICES)**

1 Purpose of the Report

To report on Treasury Management activities during the last financial year 2014-2015 and to indicate the Council's compliance with the prudential indicators set by Full Council at its meeting of 5 February 2014, in accordance with the terms of the Prudential Code for Capital Finance in Local Authorities.

2 Information and Analysis

(i) Treasury Management Activities 2014-2015

The Financial Regulations of the Council require an annual report to be presented to members. This is in accordance with the recommendations of the CIPFA Code of Practice on Treasury Management. Under the terms of the Prudential Code the Council is also required to set a series of prudential indicators each year to ensure that any capital expenditure and related borrowing undertaken is prudent, affordable and sustainable. This report compares the outcomes for the year against the prudential indicator levels approved by Full Council in February 2014.

(ii) Interest Rates

The Monetary Policy Committee (MPC) of the Bank of England (BoE) maintained the official Bank (Base) Rate at 0.50% throughout 2014-15.

The MPC's programme of asset purchases (Quantitative Easing (QE)) remained at £375 billion throughout 2014-15. QE is the process of a central bank buying assets (usually government bonds) from investors (banks, pension funds and insurance companies) using 'new' money that it has created electronically. The increased cash in the financial system should facilitate lending to business and individuals to invest or spend, which in turn should stimulate growth.

Growth was +0.3% of Gross Domestic Product (GDP) in Quarter 1 (Jan-Mar) 2015 and 2.4% Year on Year (Apr14-Mar 2015). The MPC forecast 'solid' growth of 2.5% for 2015 in their May Inflation Report.

Consumer Price Inflation (CPI) was 0% in March 2015. The MPC conceded inflation may turn negative on a temporary basis (since then -0.1% year on year in April 2015) before rising towards their 2% target in Quarter 2 (Apr-Jun) 2017.

The UK Labour Market Statistics released by the Office for National Statistics (ONS) showed the employment rate for 18 to 64 year olds increased to a record 73.5% (Jan-Mar 2015). The unemployment rate for 18 to 64 year olds was 5.5% of the economically active population (Jan-Mar 2015).

Short-term interest rates affect the amount of interest received by the Council on its investments (generally under 1 year).

Long-term interest rates will affect the amount of interest to be paid by the Council on its future borrowing (generally over 1 year).

The Public Works Loan Board (PWLB) is a statutory body that allows Local Authorities access to borrowing from the National Loans Fund at rates determined by the Treasury. The PWLB uses the published UK Treasury (Gilt-edged) stock yield for the relevant duration plus a margin of 100 Basis Points. (A Gilt is classified as the risk free return rate, as the UK Government is highly unlikely to default on its debt). All of the Council's borrowing from the PWLB is currently at fixed interest rates. The PWLB rate (and underlying Gilt rate) will vary with the supply and demand in the market (see below).

PWLB interest rates	(31-03-2015) %	(31-03-2014) %	Annual Change Basis Points (100 BP = 1%)
5 Year	2.08	2.85	- 77
10 Year	2.66	3.81	- 115
25 Year	3.32	4.49	- 117
50 Year	3.30	4.47	- 117

PWLB rates fell significantly in 2014-15. Gilt yields were driven lower due to a combination of factors including a significant fall in the oil price, deflation in the Eurozone and geopolitical tensions in the Ukraine and Middle East. Quantitative Easing (QE) in Europe and Japan and the deferral of interest rate rises in the US & UK were also contributing factors.

Derbyshire County Council is eligible for the Certainty Rate discount of 0.20% off the above rates, due to voluntarily providing details of their long term borrowing and associated capital spending plans to the Department of Local Government (DLG).

Borrowing

Total borrowing remained at all times within the limits approved under the terms of the Prudential Code.

Loans totalling £5m were repaid to the PWLB on 31/03/2015, together with temporary borrowing of £18.5m to the Derbyshire Fire and Rescue Service and £4.7m to the Peak District National Park Authority. No new borrowing was taken during the year as the Council continued to utilise its internal resources in line with its approved strategy.

At 31/03/2015 the total amount of loans outstanding for capital expenditure was £365,356,650 (nominal value) £360,185,000 (accounting value). The difference of £5.2m is due to an Effective Interest Rate (EIR) adjustment, whereby the premium incurred on rescheduling previous loans is written off over the duration of the replacement loan).

Debt Charges - 2014-15	£m
Interest Payable	24.4
Minimum Revenue Provision (MRP)	20.6
Transferred Debt (Derby City)	(1.3)
Total Debt Charges	43.7

The Council's average borrowing rate for external debt is 4.76%. The average cost of internal debt is the interest foregone at the marginal rate of return on investments, which was 0.61% for 2014-15. The average term remaining on debt at 31/03/2015 was 20.38 years.

As a result of the Local Government Reorganisation in 1997 Derby City became responsible for a share of the County Council's debt. At 31/03/2015 the value of this Transferred Debt amounted to £31.2m. Derby City Council was recharged £1.3m for servicing this debt in 2014-15.

On 05/02/2014 Full Council approved the Annual Treasury Management Strategy for 2014-15. This included performance indicators to compare the Council's cost of new borrowing against the average 25 year PWLB interest rate for maturity loans during the 2014-15 financial year. However, no new loans were taken during this period.

The Council's performance is also measured against the average rate of interest paid by County Councils for the latest financial year. Arlingclose the Council's Treasury Management advisers have provided a benchmark of their 27 County Council clients.

Performance Indicator (Borrowing) – 2014-15	%
Derbyshire County Council - (20 Year Average Term)	4.76
County Councils - (23 Year Average Term - Arlingclose)	4.78
PWLB 25 Year Rate - (Average 2014-15 rate) - (PWLB)	3.94

The table shows that Derbyshire County Council currently pays 0.82% above the average 25 year PWLB rate for 2014-15. This is due to historic borrowing taken when interest rates were higher than current rates (the 25 year PWLB rate fell by 1.17 basis points in 2014-15).

The table also shows that Derbyshire County Council pays 0.02% below the County Council average of all Arlingclose clients, (although their average term is slightly longer).

In the last 5 years, £10m of loans have being drawn/re-scheduled at an average rate of 2.72%.

(iv) Debt Rescheduling and Repayment

There was no early repayment or rescheduling of debt in 2014-15. In November 2010, the PWLB widened the margin between the repayment rate and new borrowing rate from 0.125% to 1%. This increase significantly reduced the viability of debt rescheduling or early repayment. The Council continues to review the position on a regular basis and will look to take advantage of any opportunities as they arise.

(v) Lending

Short term lending of revenue funds/capital receipts pending their use earned interest of £2.0m in 2014-15 at an average rate of 0.61%. Short-term deposits were placed with a number of financial institutions, from a counterparty list approved by Full Council.

The Council's performance is measured against a benchmark market rate of interest (the 3 month LIBID (London Inter-Bank Deposit) rate). In 2014-15, the average rate received on the Council's investments was 0.61% compared to the benchmark average of 0.50%.

The County Council's lending policy is to place security of capital and liquidity ahead of investment return.

Counterparties are constantly monitored and withdrawn from the approved list if they no longer satisfy the Council's criteria.

The Council's investments at 31 March 2015 can be analysed in the following ways:

i) Counterparty Type

Type of Institution	£m	%
Banks	102.5	35.9
Building Societies	10.0	3.5
Money Market Funds	30.0	10.5
Other Local Authorities	143.0	50.0
Total	285.5	100.0

50% of the Council's investments were to Other Local Authorities. These are considered risk free in the short term.

ii) Liquidity

The Council's access to liquidity is shown in the following table which analyses the term remaining on Council loans until maturity date:

Duration	£m	%
Less than 1 month	57.5	20.1
1 to 3 months	30.0	10.5
3 to 6 months	0.5	0.2
6 months to 1 year	185.5	65.0
Over 1 year	12.0	4.2
Total	285.5	100.0

The £150m minimum liquidity buffer of short term (<364 days) specified investments for 2014-15 was achieved.

iii) Credit Rating

The following table shows investments split according to the counterparties' credit ratings. Whilst losses from the Council's counterparties are not expected, the table also shows the historic market level of defaults for each credit rating category and an estimate of the Council's maximum exposure to default based on that experience:

Credit Rating	£m	Historic market level of default %	Estimated maximum exposure to default £m
AAA (Money Market Funds)	30.0	0%	0
AA (Local Authorities)	143.0	0%	0
AA	40.0	3%	1.2
A	72.5	7%	5.1
TOTAL	285.5		6.3

(vi) Activity in 2015-16 to date

The Council has received £25m of temporary borrowing from the D2N2 Local Enterprise Partnership.

(vii) Prudential Code for Capital Finance & Treasury Management

On 5 February 2015 Full Council approved the Capital Programme, borrowing limits and other prudential indicators for 2015-16. The levels set by Full Council and the outturns for the year 2014-15 are shown in Appendix 1. All Prudential Indicators have been complied with.

(viii) Training

A series of training sessions on financial matters has been suggested for inclusion on the Member Development Groups Training Programme. Treasury Management is included within this programme.

3 Considerations

In preparing this report the relevance of the following factors has been considered: financial, legal, prevention of crime and disorder, equality and diversity, human resources, environmental, health, property and transport considerations.

4 Call-in

Is it required that call-in be waived in respect of the decisions proposed in the report? NO

5 Background Papers

Treasury Management Strategy 2014-15
Investment Balances 2014-15
PWLB 2014-15

6 Officer's Recommendation

That the annual report on Treasury Management for 2014-2015 be noted.

PETER HANDFORD

Director of Finance

7 July 2015

APPENDIX 1**Prudential Code for Capital Finance & Treasury Management**

Compliance with Prudential Indicators 2014-15, as approved by Full Council in February 2014.

Capital Expenditure and Capital Financing Requirement

These Indicators show the total capital expenditure and the Capital Financing Requirement (CFR) for the year against the initial estimates approved in January 2014. The CFR is the Council's underlying need to borrow for capital purposes and is therefore dependent on the approved level of capital expenditure.

	2014-15 Estimate Original Jan 14 £m	2014-15 Estimate Revised Jan 15 £m	2014-15 Actual Year End £m
Capital Expenditure	152.74	126.17	106.60
CFR (Capital Financing Requirement)	546.13	501.52	492.02

Capital expenditure was lower than anticipated due to slippage. This is where capital projects are delayed due to unforeseen circumstances.

The Authorised Limit and the Operational Boundary

The Authorised Limit represents the limit beyond which borrowing is prohibited. This limit would be revised by members if necessary.

The Operational Boundary is an estimate, based upon the probable external debt during the course of the year. As this is not a limit, the actual level of borrowing may exceed this boundary.

Temporary deposits totaling £23.2m from the Derbyshire Fire Authority and the Peak District National Park Authority (included in the borrowing figure) were repaid during 2014-15.

Authorised limit for external debt	Authorised Limit for external debt 2014-15 £m	Operational Boundary for external debt 2014-15 £m	Actual external debt 2014-15 £m
Borrowing	486	436	365
PFI & other long term liabilities	87	87	82
Total	573	523	447

The above table shows that at the year end actual debt was comfortably within both the Authorised Limit and the Operational Boundary. At no stage during the year did external debt exceed the authorised limit.

Net Borrowing and Capital Financing Requirements

This indicator requires that the Council's net borrowings should not exceed its Capital Financing Requirement. Actual figures for the year ended 31 March 2015 are compared with the initial estimates approved in January 2014.

	2014-15 Estimate Jan 2014 £m	2014-15 Actual Year End £m
Gross Borrowing*	389	365.4
Transferred Debt #	(31)	(31.2)
Investments	(248)	(285.5)
Net Borrowing	141	79.9
CFR	546	493.6

- * Gross borrowing included temporary debt from the Derbyshire Fire Authority & Peak District National Park Authority, (now repaid).
- # Transferred Debt is debt held by the Council on behalf of Derby City Council, Chesterfield Borough Council & Derbyshire Police.
PFI and Finance lease liabilities of £81.6m are in addition to the Gross/Net Borrowing figures.

As outlined earlier, the use of internal resources as part of the borrowing strategy reduced both external borrowing and investments.

The above total shows that the Council's net borrowings of £79.9m are significantly less than its capital financing requirement.

Ratio of Financing Costs to Net Revenue Stream

This shows capital financing costs as a proportion of the total revenue stream of 4.6% of total revenue, including Dedicated Schools Grant (DSG) and 8.4% excluding DSG.

Incremental Impact on Council Tax

The impact in the year of new financing costs was within the estimate.

Fixed and Variable Rate Exposures

Recommended upper limits on the percentage of borrowing and investments held at fixed and variable rates, as required by the Code, are set out below:

	2014-15 Upper Limit	2014-15 Actual Year End
Borrowing		
Limits on fixed interest rates	100%	92.34%
Limits on variable interest rates*	40%	7.66%
Investments		
Limits on fixed interest rates	25%	0%
Limits on variable interest rates	100%	100%

- The Council has £28m of Lenders Option Borrowers Option (LOBO) loans, which are fixed rate loans with an option for the lender to vary the interest rate every 6 months. If the lender exercises this option then the Council has the option to repay the loan in full without penalty.

The Council's borrowing and investments remained within the approved limits.

Maturity Structures

The maturity profile is the rate at which long-term loans have to be repaid to the PWLB (or other lenders). It would be imprudent to have a large proportion of repayments in any one year, thus a spread of redemptions is desirable.

The maturity structure is a prudential indicator under the Code, with lower and upper limits recommended as shown in the table below. These are set quite widely to ensure that full advantage can be taken of interest rate movements and debt rescheduling opportunities, within an acceptable degree of risk.

Borrowing Maturity Structure Term	Limits Lower-Upper %	Amount £m	2014-15 Actual Year End
Under 12 months	0-15	15.00	4.10
12 months - 2 years	0-15	12.50	3.42
2 years - 5 years	0-40	23.00	6.30
5 years - 10 years	0-40	23.00	6.30
10 years - 20 years	10-40	100.00	27.37
20 years - 30 years	10-40	111.01	30.38
30 years and above	10-40	80.85	22.13
Total		365.36	100.00

The above analysis **excludes** PFI, finance lease liabilities and temporary borrowing.

The Council's debt maturity structure as at 31 March 2015 complied with the limits approved by Full Council.

Longer Term Investments

The prudential code requires councils to set limits for any investments made for more than 364 days. Whilst most of the Council's surpluses are of a temporary nature, others, for example the insurance fund reserve, could reasonably be invested for periods in excess of one year.

A limit for lending for more than one year is set out below and compared with the total amount on deposit at 31 March 2015. The total includes all loans outstanding at 31 March 2015 which, at inception, had over 1 year to maturity.

	2014-15 Limit	2014-15 Actual
Maximum principal sums invested for more than 364 days	£100m	£12m

Longer term investments complied with the limit approved by Full Council.