Cabinet

16 July 2014

Treasury Management Outturn 2013/14

Durham County Council

Report of Corporate Management Team

Don McLure, Corporate Director Resources

Councillor Alan Napier, Cabinet Portfolio Holder for Finance

Purpose of the Report

1 The regulatory framework of Treasury Management on the Council's cash management, loans and investments requires that the Council receive, comment upon and agree Treasury Management review reports. This report is therefore to update Cabinet with the annual treasury management report for the year ended 31 March 2014.

2 As well as meeting the regulatory framework, the report also incorporates the needs of the 'Prudential Code', which can be regarded as being best operational practice, to ensure adequate monitoring of the Council's capital expenditure plans and prudential indicators (PIs). The treasury strategy and PIs for 2013/14 were previously reported to Council as part of the Medium Term Financial Plan 2013/14 – 2016/17 on 20 February 2013.

3 The report also supports the objective in the revised Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management and the Communities and Local Government Investment Guidance. These state that Members should receive reports and scrutinise the Treasury Management service.

Background

4 Treasury Management is the management of the Council's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities, and the pursuit of optimum performance consistent with those risks. It is concerned with how the Council manages its cash resources and its scope covers borrowing, investment and hedging instruments and techniques. Risk is inherent in all treasury management activities and it is necessary to balance risk against return on investment.

5 The financial year 2013/14 continued to be the challenging investment environment of previous years of low investment returns, although levels of counterparty risk had subsided. The original expectation for 2013/14 was that Bank Rate would not rise during the year and for it only to begin to gradually rise from quarter 1 of 2015. Bank rates did stay the same and this forecast rise has now been revised to a delayed start of quarter 3 of 2015.

6 Economic growth (GDP) in the UK had been virtually flat during 2012/13 but it grew 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. Consumer Price Index (CPI) inflation remained high and substantially above the 2% target during 2012, but by January 2014 it had 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 Gilt yields had been on a sharply rising trend during 2013 but volatility had returned in the first quarter of 2014.

8 The Government's Funding for Lending Scheme, announced in July 2012, resulted in cheap credit being made available to banks which resulted in money market investment rates falling significantly 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 due to concerns over the impact on rising house prices.

9 The UK 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 forecasted £5bn surplus in 2018/19.

10 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 European Central Bank 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, the problems of the Eurozone, or its banks may not 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. Future stress tests of Eurozone banks could also reveal some areas of concern.

Treasury Position

11 The Treasury position at the beginning and end of 2013/14 is shown in the table below:

	31-Mar-13 (Restated)	Rate/ Return	Average Life	31-Mar-14	Rate/ Return	Average Life
	£m	%	yrs	£m	%	yrs
Total Debt	440	4.61		437	4.49	
Capital Financing Requirement (CFR)	603			607		
Over / (-) Under Borrowing	-163			-170		
Total Investments	112	1.72	0.3	152	0.71	0.3
Net Debt	328			285		

12 Investments increased by £40m across the period as a result of re-profiling of the capital programme and a lower than anticipated use of reserves. Due to the reduction of interest rates offered by high quality counterparties by 1.00%, the average rate earned on those balances fell during 2013/14.

13 The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).

14 As a result of the favourable cash balances position, no new borrowing was raised during the year.

Capital Expenditure and Financing

15 The Council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants or revenue contributions), which has no resultant impact on the Council's borrowing need, or

- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

16 Actual capital expenditure forms one of the required prudential indicators. The table below shows actual capital expenditure in 2013/14 and how this was financed.

	2012/13 Actual	2013/14 Estimate	2013/14 Actual
	£m	£m	£m
Non-HRA Capital Expenditure	117.09	135.74	107.11
Non-HRA PFI and Finance Lease	5.09	-	2.48
HRA Capital Expenditure	43.92	50.31	45.70
Total capital expenditure	**166.10**	**186.05**	**155.29**
Resourced by:			
Capital receipts	9.12	16.59	8.15
Capital grants	76.44	81.72	91.64
Capital reserves and Revenue	39.25	31.82	35.38
Unfinanced capital expenditure	**41.29**	**55.92**	**20.12**

Overall Borrowing Need

17 The CFR results from the capital activity of the Council and what resources have been used to pay for the capital spend. It represents the 2013/14 unfinanced capital expenditure (see above table), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

18 Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the Corporate Director Resources' treasury management team organises the Council's cash position to ensure sufficient cash is available to meet the capital plans and cash flow requirements.

19 This may be sourced through borrowing from external bodies (such as the Government, through the PWLB or the money markets), or utilising temporary cash resources within the Council.

20 The Council's (non HRA) underlying borrowing need known as its capital finance requirement (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision (MRP), to reduce the CFR. This is effectively a repayment of the non-HRA borrowing need (there is no statutory requirement to reduce the HRA CFR).

21 The Council's 2013/14 MRP Policy, as required by the Department of Communities and Local Government (CLG) guidance was approved as part of the Treasury Management Strategy Report for 2013/14 on 20 February 2013.

22 The Council's CFR for the year is shown in the following table, and represents one of the key prudential indicators. The 2012/13 CFR has been restated as follows:

- To correct the opening CFR, which was overstated.

- To recognise the impairment in 2012/13 of the Durham County Waste Management Company loan; this has reduced the CFR.

- To recognise HRA non-dwelling impairment, which can no longer be reversed to the Capital Adjustment account, and which has the effect of reducing the CFR.

CFR	**31-Mar-13 Actual (Restated)**	**31-Mar-14 Estimate**	**31-Mar-14 Actual**
	£m	**£m**	**£m**
Opening balance	579.135	604.828	603.431
Add unfinanced capital expenditure (as above)	41.293	55.921	20.117
Less MRP/VRP	-15.600	-16.005	-16.018
Adjusted for:			
Restatement of Opening Balance	-0.573		
Impairment of Loan	-0.801		
HRA non-dwelling impairment/revaluation losses	-0.023		-0.270
Closing balance	**603.431**	**644.744**	**607.260**

23 The borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit. In order to ensure that borrowing levels are prudent over the medium term the Council's external borrowing, net of investments, must only be for a capital purpose. This essentially means that the Council is not borrowing to support revenue expenditure.

24 The authorised limit is the "affordable borrowing limit" required by section 3 of the Local Government Act 2003. The Council does not have the power to borrow above this level.

25 The operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary is acceptable subject to the authorised limit not being breached.

26 The table below demonstrates that during 2013/14 the Council has maintained gross borrowing within its authorised limit.

	2013/14 £m
Authorised limit	746.000
Operational boundary	693.000
Maximum gross borrowing position	440.389
Average gross borrowing position	438.625

Investment Strategy

27 The prime objective of the Council's Investment Strategy is to ensure prudent investment of surplus funds. The Council's investment priorities are therefore the security of capital, liquidity of investments and, within those objectives, to secure optimum performance. The Council has regard to the CLG Guidance and the CIPFA Treasury Management Code when making decisions.

28 Therefore the primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration.

Selection Criteria

29 The criteria for providing a pool of high quality investment counterparties are:

i. Banks 1 – the Council's strategy requires the use of UK banks only which have, as a minimum, the following Fitch, Moody's and Standard and Poors credit ratings (where rated):

	Fitch	**Moody's**	**Standard & Poors**
Short Term	F1	P1	A-1
Long Term	A	A2	A
Viability/Financial Strength	BB-	C-	-
Support	3	-	-

ii. Banks 2 - Part nationalised UK banks – Lloyds Bank and Royal Bank of Scotland. These banks are included so long as they continue to be part nationalised or they meet the ratings in Banks 1 above.

iii. Banks 3 – Co-operative Bank - The Council's own banker for transactional purposes. If the bank falls below the above criteria balances will be minimised in both monetary size and time.

iv. Bank subsidiary and treasury operation. The Council will use these where the parent bank has provided an appropriate guarantee or has the necessary ratings outlined above.

v. Building societies. The Council only uses building societies which meet the ratings for banks outlined above.

vi. Money Market Funds.

vii. UK Government (including gilts, Treasury Bills and the Debt Management Account Deposit Facility).

viii. Local authorities and parish councils.

Time and Monetary Limits applying to Investments

30 The time and monetary limits for institutions on the Council's Counterparty List for 2013/14 were as follows:

	Long Term Rating	Money Limit	Time Limit
Banks 1 category high quality	AA	£50m	1 year
Banks 1 category medium quality	A	£25m	3 months
Banks 2 category – part-nationalised	n/a	£60m	1 year
Banks 3 category – Council's banker	A-	£25m	3 months
DMADF/Treasury Bills	AAA	unlimited	6 months
Local Authorities	n/a	£10m each	1 year
Money Market Funds	AAA	£10m each (overall £50m)	liquid

Icelandic Deposits Update

31 In October 2008, the Icelandic banks Landsbanki, Kaupthing and Glitnir collapsed and the UK subsidiaries of the banks, Heritable and Kaupthing Singer and Friedlander went into administration. The authority had £7m deposited across three of these institutions, with varying maturity dates and interest rates as follows:

Bank	Date Invested	Maturity Date	Amount Invested	Interest Rate
			£	%
KSF	30/10/07	28/10/08	1,000,000	6.120
Landsbanki (1)	12/04/07	13/10/08	1,000,000	6.010
Landsbanki (2)	12/04/07	14/04/09	1,000,000	6.040
Glitnir Bank (1)	25/10/06	24/10/08	3,000,000	5.620
Glitnir Bank (2)	18/12/07	16/12/08	1,000,000	6.290
Total			**7,000,000**	

32 All monies within these institutions are currently subject to the respective administration and receivership processes. The amounts and timing of payments to depositors such as the Council will be determined by the administrators / receivers.

33 The current situation concerning the recovery of sums deposited varies between each institution.

Kaupthing Singer and Friedlander Ltd

34 The current position on actual amounts received and estimated future receipts are as shown in the table. The Council has recognised an impairment based on it recovering 85.75p in the £ compared to 85.25p in the £ at 31 March 2013.

Date	Repayment
	%
Received to 31 March 2014	81.50
Received in June 2014	2.00
June 2015	2.25

35 Recoveries are expressed as a percentage of the authority's claim in the administration, which includes interest accrued up to 7 October 2008.

Landsbanki

36 Landsbanki Islands hf is an Icelandic entity. Following steps taken by the Icelandic Government in early October 2008 its domestic assets and liabilities were transferred to a new bank (new Landsbanki) with the management of the affairs of Old Landsbanki being placed in the hands of a resolution committee.

37 The Icelandic Supreme Court's decision to grant UK local authorities priority status was followed by the winding up board making a distribution to creditors in a basket of currencies in December 2011. Further distributions were made in May 2012, October 2012 and September 2013 respectively.

38 An element of the distribution was in Icelandic Krona which was placed in an escrow account in Iceland and was earning interest of 4.17% as at 31 March 2013. This element of the distribution was retained in Iceland due to currency controls currently operating in Iceland and as a result was subject to exchange rate risk, over which the Council has no control.

39 During 2013/14, the Council sold its claims against the insolvent estate of Landsbanki through a competitive auction process. The price at which the claims were sold was based on a reserve price set by the Council, on the basis of legal advice received through the Local Government Association and its lawyers Bevan Brittan.

40 The administration of the insolvent estate of Landsbanki is likely to continue for several years given the complexity of the on-going issues in Iceland, which created uncertainty around the timings of future recoveries. The sale of the Council's claims has removed this uncertainty.

41 The sale included the Icelandic Kronur which had been held in an escrow account in Iceland since it was paid with the first distribution to priority creditors in December 2011.

42 The proceeds of the sale were paid in Pounds Sterling and were received in February 2014 so the Council is no longer a creditor of Landsbanki.

Glitnir Bank hf

43 Glitnir Bank hf is also an Icelandic entity. Following steps taken by the Icelandic Government in early October 2008 its domestic assets and liabilities were transferred to a new bank (new Glitnir) with the management of the affairs of Old Glitnir being placed in the hands of a resolution committee.

44 The Icelandic Supreme Court's decision to grant UK local authorities priority status was followed by the winding up board made a distribution to creditors in a basket of currencies in March 2012.

45 An element of the distribution is in Icelandic Krona which has been placed in an escrow account in Iceland and earned interest of 3.4% up to 22 June 2012 and thereafter is earning 4.2%. This element of the distribution has been retained in Iceland due to currency controls currently operating in Iceland and as a result is subject to exchange rate risk, over which the Council has no control.

46 The distribution has been made in full settlement, representing 100% of the claim.

Recommendations and Reasons

47 It is recommended that Cabinet:

- Note the Treasury Management Outturn position for 2013/14.

Background Papers

a) 16 July 2014 – Cabinet - 2013/14 Final Outturn for General Fund, Housing Revenue Account and Collection Fund.

b) 20 February 2013 – County Council - General Fund Medium Term Financial Plan, 2013/14 – 2016/17 and Revenue and Capital Budget 2013/14

c) 26 February 2014 – County Council - General Fund Medium Term Financial Plan, 2014/15 to 2016/17 and Revenue and Capital Budget 2014/15

Contact: Jeff Garfoot Tel: 03000 261946

Appendix 1: Implications

Finance

The report details of the overall financing of the Council's anticipated capital expenditure, along with forecast borrowing and investment income returns are provided in the report.

Staffing

None.

Risk

None.

Equality and Diversity / Public Sector Equality Duty

None.

Accommodation

None.

Crime and Disorder

None.

Human Rights

None.

Consultation

None.

Procurement

None.

Disability Issues

None.

Legal Implications

None.