Cabinet

15 July 2015

Treasury Management Outturn 2014/15

Report of Corporate Management Team
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Purpose of the Report

1 To update Cabinet with the annual Treasury Management report for the year ended 31 March 2015.

Background

2 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. 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.

3 It is concerned with how the Council manages its cash resources and its scope covers borrowing, investment and hedging instruments and techniques.

4 Risk is inherent in all treasury management activities and it is necessary to balance risk against return on investment.

5 As well as meeting the regulatory framework, this 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 2014/15 were agreed by the Council as part of the Medium Term Financial Plan 2014/15 – 2016/17 on 26 February 2014 and have been updated since as part of the Medium Term Financial Plan 2015/16 to 2017/18 report that was agreed by the Council on 25 February 2015.

6 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 as part of good governance and best practice.

7 During 2014/15 the minimum reporting requirements were that the full Council should receive the following reports:

- an annual treasury strategy in advance of the year (County Council 26 February 2014)
- a mid-year treasury update report (County Council 3 December 2014)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

2014/15 External Influences

8 Financial year 2014/15 continued to be the challenging investment environment of previous years with low investment returns, although levels of counterparty risk had subsided. The original market expectation at the beginning of 2014/15 was for the first increase in Bank Rate to occur in quarter 1 of 2015 as the unemployment rate had fallen much faster than expected through the Bank of England's initial forward guidance target of 7%.

9 In May 2014 however, the Bank revised its forward guidance. A combination of very weak pay rises and inflation above the rate of pay rises, meant that consumer disposable income was still being eroded and in August 2014 the Bank halved its forecast for pay inflation for the whole of 2014 from 2.5% to 1.25%.

10 Expectations for the first increase in Bank Rate therefore started to recede as growth was still heavily dependent on buoyant consumer demand.

11 During the second half of 2014 financial markets were caught out by the halving of the oil price and the Swiss National Bank announcing that it would no longer hold the Swiss Franc (CHF) at a fixed exchange rate with the Euro. Fears also increased considerably that the European Central Bank (ECB) was going to do "too little too late" to ward off the threat of deflation and recession in the Eurozone.

12 By the end of 2014, it was clear that inflation in the UK was going to head towards zero in 2015 and possibly even become negative. In turn, this made it clear that the Monetary Policy committee (MPC) would have great difficulty in starting to raise the Bank Rate in 2015 while inflation was around zero and so market expectations for the first increase receded back to around quarter 3 of 2016.

13 Gilt yields were on a falling trend for much of the last eight months of 2014/15 but were then pulled in different directions by increasing fears after the anti-austerity parties won power in Greece in January Developments since then have increased fears that Greece could be heading for an exit from the Euro. While the direct effects of this would be manageable by the European Union (EU) and ECB, it is difficult to quantify what the potential knock on effects would be on other countries in the Eurozone once the supposed "impossibility of a country leaving the Eurozone" had been disproved.

14 A further downward pressure on gilt yields was the announcement in January 2015 that the ECB would start a major programme of quantitative easing, purchasing Eurozone government and other debt in March 2015.

15 On the other hand, strong growth in the United States (US) caused an increase in confidence that the US was well on the way to making a full recovery from the financial crash and would be the first country to start increasing its central interest rate, probably by the end of 2015.

16 The UK would be closely following it due to strong growth over both 2013 and 2014 and good prospects for a continuation into 2015 and beyond. However, there was also an increase in concerns around political risk from the general election in May 2015.

Treasury Position for the Council

17 The Treasury position for the Council across 2014/15 is shown in the table below:

	31-Mar-14	Rate/ Return	Average Life	31-Mar-15	Rate/ Return	Average Life
	£m	%	years	£m	%	years
Total Debt	437	4.49		457	4.45	
Capital Financing Requirement (CFR)	607			636		
(-) Under Borrowing	-170			-179		
Total Investments	152	0.71	0.3	238	0.71	0.35
Net Debt (total debt less total investments)	285			219		

18 Investments increased by £86m across the period as a result of re-profiling of the capital programme, a lower than anticipated use of reserves and new borrowing.

19 To take advantage of favourable interest rates, new borrowing of £25m for 42 years at 4% was raised during the year.

Capital Expenditure and Financing

20 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.

21 Actual capital expenditure forms one of the required prudential indicators. The table below shows actual capital expenditure in 2014/15 and how this was financed.

	2013/14 Actual	2014/15 Budget	2014/15 Actual
	£m	£m	£m
Non-HRA Capital Expenditure	107.110	149.253	117.214
Non-HRA PFI and Finance Lease	2.480	3.419	2.172
HRA Capital Expenditure	45.698	46.717	42.826
Total capital expenditure	**155.288**	**199.389**	**162.212**
Resourced by:			
Capital receipts	8.150	10.879	12.976
Capital grants	91.643	80.998	75.390
Capital reserves and Revenue	35.378	31.194	29.049
Unfinanced capital expenditure	**20.117**	**76.318**	**44.797**

Overall Borrowing Need

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

23 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 2014/15 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.

24 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.

25 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.

26 The Council's non HRA 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).

27 The Council's 2014/15 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 2014/15 on 26 February 2014 and updated on 25 February 2015.

- The Council's CFR for 2015/16, as agreed in February 2015, is shown in the following table, and represents one of the key prudential indicators.

CFR	**31-Mar-14 Actual**	**31-Mar-15 Estimate**	**31-Mar-15 Actual**
	£m	**£m**	**£m**
Opening balance	603.431	607.260	607.260
Add unfinanced capital expenditure (as above)	20.117	76.318	44.797
Less MRP/VRP	-16.018	-16.055	-15.730
Adjusted for:			
HRA non-dwelling impairment/revaluation losses	-0.270		0.132
Housing Stock Transfer		-236.933	
Closing balance	**607.260**	**430.590**	**636.459**

28 At the time that the revised 2014/15 budget was reported to County Council in February 2015, it was anticipated that the Housing Stock Transfer would take place in March 2015. However, the transfer of Housing Stock did not take place until 13 April 2015 and is therefore not reflected in the calculation of the Actual 2014/15 CFR.

29 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.

30 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.

31 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.

32 The table overleaf demonstrates that during 2014/15 the Council has maintained gross borrowing within its authorised limit.

	2014/15 (original) £m	2014/15 (revised) £m
Authorised limit	759.000	484.000
Operational boundary	706.000	431.000
Maximum gross borrowing position		458.659
Average gross borrowing position		457.517

Investment Strategy

33 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.

34 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

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

- Banks 1 **–** the Council will only use UK banks and have, as a minimum, the following Fitch, Moody's and Standard and Poors credit ratings (where rated):

	Fitch	Moody's	Standard and Poors
Short Term	F1	P1	A-1
Long Term	A-	A3	A-

- Non UK Banks 1 **–** the Council will only use non UK banks which have, as a minimum, the following Fitch, Moody's and Standard and Poors credit ratings:

	Fitch	Moody's	Standard and Poors
Sovereign Rating	AAA	AAA	AAA
Short Term	F1+	P1	A1+
Long Term	AA-	Aa3	AA-

(N.B. Viability, Financial Strength and Support ratings have been removed and will not be considered in choosing counterparties.)

- Banks 2 – Part nationalised UK banks – Lloyds Banking Group and Royal Bank of Scotland. These banks can be included if they continue to be part nationalised or they meet the ratings in Banks 1 above.

- Banks 3 – The Council’s own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time.

- 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.

- Building societies. The Council will use societies which meet the ratings for banks outlined above:
- Money market funds

- Enhanced money market funds (EMMFs)

- UK Government (including gilts and the Debt Management Account Deposit Facility [DMADF])

- Other local authorities and parish councils.

Time and Monetary Limits applying to Investments

36 The time and monetary limits for institutions on the Council’s Counterparty List are as follows (these will cover both Specified and Non-Specified Investments):

	Long Term Rating	**Money Limit**	**Time Limit**
Banks 1 higher quality	AA-	£50m	2 years
Banks 1 medium quality	A	£35m	1 year
Banks 1 lower quality	A-	£25m	100 days
Banks 2 category – part-nationalised	n/a	£60m	2 years
Banks 3 category – Council’s banker	A-	£25m	3 months
DMADF/Treasury Bills	AAA	unlimited	6 months
Local Authorities	n/a	£10m each	5 years
Money Market Funds	AAA	£20m each (overall £100m)	liquid

Icelandic Deposits Update

37 The County Council had £7m deposited across the Icelandic banks Glitnir Bank hf (£4m), Landsbanki (£2m) and Kaupthing Singer and Friedlander Ltd (£1m), which all collapsed financially in October 2008.

38 The Council’s recovery position at 31 March 2015 is as follows:

- Glitnir: a full distribution was made in March 2012, however an element of the distribution was in the Icelandic Kroner currency, which was placed in an escrow account in Iceland due to currency controls currently operating in the country. As a result, this element had been subject to exchange rate risk, over which the Council had no control. Following a currency auction in February 2015, the Council has repatriated this money and is no longer a creditor of Glitnir. In total the Council received £4.136m against its £4.000m investment.

- During 2013/14, the Council sold its claims against the insolvent estate of Landsbanki through a competitive auction process. 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. In total the Council received £2.032m against its £2.000m investment.

- Kaupthing Singer and Friedlander: 82.5% of the outstanding balance has been repaid. 85.75% recovery is anticipated in the long run.

Kaupthing Singer and Friedlander Ltd

39 The current position on actual amounts received and estimated future receipts are as shown in the table. The Council has recognised an impairment of £3k in 2014/15 based on it recovering 85.75p in the £ as was anticipated at 31 March 2014. The phasing of the repayments has been amended in 2014/15 to a more prudent expectation of the likely repayment.

Date	**Repayment**
	%
Received to 31 March 2015	82.50
Due 31 December 2015	1.50
Due 31 December 2016	1.75

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

Glitnir Bank hf

41 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.

42 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.

43 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 was earning 4.2%. This element of the distribution had been 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 had no control.

44 Following a decision of the Icelandic Supreme Court on 25 September 2013, the Winding up Board of Glitnir had to apply the Central Bank of Iceland's

(CBI's) official selling rates as at the date of the distribution when calculating the value of payments being made to Creditors in Icelandic Kroner (ISK). Previously, the exchange rate as at 22 April 2009 had been applied to all distributions made. The impact of this decision is that there was on-going uncertainty in relation to the sterling value of any future distributions.

45 The total amount of ISK held in escrow on behalf of Glitnir Creditors is around ISK 8.9bn (the equivalent of around £47m) excluding interest earned since March 2012.

46 The LGA, who work on behalf of the Local Authorities with Icelandic deposits, have discussed the potential options for converting the ISK into another currency and repatriating it to the UK.

47 It is important to note that Creditors, like the Council were unable to access the escrowed ISK unless and until:

- the Central Bank of Iceland (CBI) approved the requests which had been made by the winding-up boards (WUBs) to exempt the escrowed ISK from the capital controls so that the ISK could be paid from the escrow accounts to each individual Creditor (i.e. into an ISK account in each Creditor's name) or

- the capital controls are lifted. The date on which the controls will be lifted remains unknown but the Icelandic government has recently announced that it is taking steps towards that goal. Currency auctions are one of those steps.

48 The CBI periodically holds a currency auction to allow parties to:

(i) purchase ISK solely for the purpose of long term investment in Iceland;

(ii) purchase Iceland treasury bonds; and

(iii) purchase EUR (i.e. an outflow of ISK) in exchange for ISK.

49 The auctions are part of the CBI's strategy for an "orderly" removal of the capital controls. (i) and (ii) above result in an inflow of foreign currency into Iceland. (iii) enables holders of ISK to exchange their ISK for EUR.

50 The part of the auction that is relevant to Local Authority Creditors is (iii), the sale of ISK in exchange for EUR. In past auctions, the CBI has sought to match the inflow of foreign currency with the outflow of foreign currency. Given that the demand for foreign currency usually outstrips the supply of foreign currency in the CBI's auctions, previous auctions have resulted in a relatively low level of foreign currency outflow.

51 The consensus among most foreign creditors of the insolvent banks is that when the capital controls are ultimately lifted there is a very real risk that the value of the ISK will fall against other currencies. There is uncertainty as to when the capital controls will be lifted, although there is speculation in recent Icelandic media reports that this may happen during the course of 2015.

52 The CBI is currently reviewing ways in which it can relax the capital controls in a way that will not negatively affect Iceland's financial stability. Various commentators in Iceland have suggested that this is may involve the imposition of an "exit tax" (with suggestions of up to 30-40%) on creditors of the failed Icelandic banks. It is not yet known which creditors might be affected by any such tax or how any such tax might be applied but it may be applied to cross-border capital movement, such as the repatriation of escrowed ISK. If it is, this will have a negative impact on the value of Creditors' escrowed ISK.

53 In February 2015 the CBI amended the rules for their currency auctions which allowed qualifying creditors, such as UK local authorities to participate.

54 The LGA administered a process for the sale of the escrowed ISK on behalf of local authority creditors. Local Authorities were required to submit a price for the sale of the escrowed ISK to buy Euros.

55 Through this process, the Council sold ISK 178m which bought €0.890m. Including the bank's fee, the Council paid an all-in rate of ISK 201 for €.

56 The currency auction only accepted amounts in round millions of ISK for sale, so after selling ISK 178m and paying fees of ISK 0.890m from the escrow account, an amount of ISK 0.279m remains in the Glitnir escrow in Iceland. At current exchange rates this is worth in the region of £1,400.

57 The Council has impaired the value of Glitnir investments in its accounts by £0.267m. This takes account of the change in the exchange rate of the investments from 31 March 2014 to the sale of the investment in February 2015 along with the loss on the sale of the investments and the write off of the amount remaining in the escrow in Iceland. There is now no balance due in respect of Glitnir in the Council's accounts.

58 The Council is no longer a creditor of Glitnir.

Recommendations and Reasons

59 It is recommended that Cabinet:

- Note the Treasury Management Outturn position for 2014/15.

Background Papers

a) 15 July 2015 – Cabinet - 2014/15 Final Outturn for General Fund, Housing Revenue Account and Collection Fund.

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

c) 03 December 2015 – County Council - Mid-Year Report for the Period to 30 September 2014 on Treasury Management Service

d) 25 February 2015 – County Council - General Fund Medium Term Financial Plan, 2015/16 – 2017/18 and Revenue and Capital Budget 2015/16

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Appendix 1: Implications

Finance

The report details the Council's cash management, loans and investment activity in 2014/15. The report also provides the overall financing of the Council's capital expenditure, along with borrowing and investment income returns.

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.