POLICY AND RESOURCES SCRUTINY COMMITTEE – 3RD MARCH 2015

SUBJECT: TREASURY MANAGEMENT AND CAPITAL FINANCING PRUDENTIAL INDICATORS MONITORING REPORT (1ST APRIL 2014 TO 31ST DECEMBER 2014)

REPORT BY: ACTING DIRECTOR OF CORPORATE SERVICES AND SECTION 151 OFFICER

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1. PURPOSE OF REPORT

1.1 To present Members with details of Treasury Management activities and Capital Financing, together with the related Prudential Indicators for the period 1st April 2014 to 31st December 2014.

1.2 To review the Treasury Management Strategy for 2014/2015 as set out in the Annual Investment Strategy and Capital Financing Prudential Indicators Report.

2. SUMMARY

2.1 The Code of Practice on Treasury Management in the Public Services 2009, which was adopted by the Council on 12th October 2010, sets out a framework of operating procedures, which is encompassed in the Treasury Management Practices (TMPs). TMP6 (Reporting Requirements and Management Information Arrangements) provides for the submission of monitoring reports to the appropriate Committee on a quarterly basis.

2.2 Under the provisions of the Local Government Act 2003, The Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003 [The Capital Regulations], and the CIPFA's "The Prudential Code for Capital Finance in Local Authorities" [the Code], the Authority is obliged to approve and publish a number of indicators relevant to Capital Finance and Treasury Management.

2.3 The Authority's Annual Investment Strategy and Capital Financing Prudential Indicators for 2014/2015 were approved by Council on 26th February 2014.

3. LINKS TO STRATEGY

3.1 Treasury Management Strategy 2014/2015 as agreed by Council on 26th February 2014.

4. THE REPORT

4.1 Treasury Management

4.1.1 <u>Loans administered by Caerphilly CBC</u>

Due to the current level of interest rates, the difference between long-term borrowing rates and short-term investment rates has given rise to a cost of carry risk. The current policy of internal borrowing is not sustainable in the long-term, but where prudent the policy of internal borrowing will be utilised. A review of the balance sheet for 2013/2014 shows that the level of internal borrowing was not as high as anticipated. At 31st March 2014 the internal borrowing position was £39m.

The Annual Treasury Management Strategy approved by Council in February 2014 indicated that there would be a need to borrow £19.8m in 2014/2015 to part fund the Capital Programme. £7.8m of this total would be met through supported borrowing approvals (inclusive of £2.8m for the Highways LGBI capital works); £4m for Bargoed Cinema and £8m for WHQS (General Fund contribution). The General Fund will not be able to contribute £8m of new borrowings towards the WHQS programme due to advice subsequently received from Welsh Government.

As at the 31st December 2014 the Authority had taken £36.52m of new 25-year PWLB debt to fund capital expenditure. The Authority had achieved a loan rate of 2.82% on an annuity loan structure. PWLB rates had been in free fall since mid November as a result of volatility in the bond markets caused by uncertainty in the Eurozone (the start of the quantitative easing; fear of Greece defaulting; falling oil prices and poor economic data). Investors had sought comfort in Gilts, causing Gilt yields to fall and subsequently PWLB yields had fallen. The debt taken was planned debt that had been deferred since 2011/12 financial year, but budgeted within the medium term financial plan. The £36.52m loan includes LGBI Highways; Caerphilly Library; Supported borrowing approvals and an element of the LGBI 21st Century Schools. It does not include the borrowing for the Cinema as this will be subject to a future report to Council.

Borrowing rates during the period covered by the report have fallen compared to the forecasted rates as reported in the 2014/15 Treasury Management Strategy. Economic recovery continues to remain fragile and falling inflation is considered to be a threat towards UK economic recovery as well as the economic recovery within the Eurozone.

During the period covered by this report, PWLB loans to the value of £645k were repaid on maturity. Such loans had an average interest rate of 7.06%. £30k of the WRU Loan was also repaid.

Total debt outstanding as at 31st December 2014 was £218.07m and comprised of £177.80m PWLB loans; £40m market loans; and £270k WRU loan.

During the reported period no LOBO loans were called by the respective lender despite an interest rate review for the respective loan. As a result, and for the remaining 2014/15 financial year the Authority’s debt portfolio variable interest rate proportion at 31st December 2014 stood at 0%, which is within the Council’s determination of 50%. Two £10m LOBO loans will be reviewed next in May 2015.

4.1.2 <u>Rescheduling</u>

The Annual Strategy allows for the utilisation of debt rescheduling to provide for both in year and future year savings and additional revenue resources. No rescheduling opportunities presented themselves during the period covered by this report.

4.1.4 Long-Term Investments

The Council no longer holds any long-term investments.

4.1.5 Short-Term Investments (Deposits) – Up to 364 Days

The value of short-term deposits at 31st December 2014 was £131.58m and is made up of a spread of periods up to a maximum of three months. The average rate earned on deposits during the reported period was 0.27%, which compares favourably with the Debt Management Account Deposit Facility (DMADF) deposit rate of 0.25%, and is above the target rate, as detailed in the Annual Treasury Management Strategy report to Council, of 0.25%. The low returns reflect the Council's current risk sentiment as well as current interest rates. The portfolio as at 31st December 2014 comprised of £122.40m deposited with Local Authorities and £9.18m deposited in the DMADF.

4.1.6 Economic Outlook

There is momentum in the UK economy, with a continued period of growth through domestically-driven activity and strong household consumption. There are signs that growth is becoming more balanced. The greater contribution from business investment should support continued, albeit slower, expansion of GDP. However, inflationary pressure is benign and is likely to remain low in the short-term. There have been large falls in unemployment but levels of part-time working, self-employment and underemployment are significant and nominal earnings growth remains weak and below inflation.

Whilst the Bank of England has maintained the Bank Rate at 0.50% and asset purchases at £375bn, the MPC's focus is on both the degree of spare capacity in the economy and the rate at which this will be used up, factors prompting some debate on the Committee. Despite two MPC members having voted for a 0.25% increase in rates at each of the meetings August 2014 onwards, some Committee members have become more concerned that the economic outlook is less optimistic than at the time of the August Inflation Report.

The Authority's treasury management advisor, Arlingclose, forecasts the first rise in official interest rates in August 2015 and a gradual pace of increases thereafter, with the average for 2015/16 being around 0.75%. Arlingclose believes the normalised level of the Bank Rate post-crisis to range between 2.5% and 3.5%. The risk to the upside (i.e. interest rates being higher) is weighted more towards the end of the forecast horizon. On the downside, Eurozone weakness and the threat of deflation have increased the risks to the durability of UK growth. If the negative indicators from the Eurozone become more entrenched, the Bank of England will likely defer rate rises to later in the year.

Gilt yields have continued to decline and PWLB loan rates hit a financial year low at the end of December 2014. What has driven yields lower is a combination of factors but the primary drivers have been the weak economic data from the Eurozone; the possibility of Greece exiting the Eurozone and re-negotiating the bailout terms; and falling oil prices as a result of excess supply in the market caused by the US's switch to domestic production and falling demand from China. The geo-political risk within the Middle East and Ukraine alongside the slide towards deflation within the Eurozone continues to remain.

4.1.7 Bank Tender

The Authority has extended the current short-term bank contract with Barclays up until 28th February 2015. It is expected that a long-term contract with a suitable bank will be in place by then following the conclusion of the current bank tender exercise that was still ongoing at the time of this report.

4.1.8 Treasury Management Advisors Contract

The Authority is currently advised by Arlingclose Limited. The contract commenced in April 2014.

4.2 Prudential Indicators

4.2.1 Capital Financing Requirement

The Capital Financing Requirement (CFR) measures the Authority's underlying need to borrow for a capital purpose. In accordance with best professional practice, the Authority does not associate borrowing with particular items or types of expenditure. In practice, the raising and repaying of loans is determined primarily by professional / expert advice, and may not necessarily take place in the relevant year. In order to create an operating environment within which the Treasury Manager can legitimately react to appropriate advice, the various authorised limits as identified in Appendix 1 are set at a level in excess of the CFR. In the financial year to date, the Authority has been operating within the approved limits.

Appendix 2 shows a projected CFR value of £293.29m as at 31st March 2015. The actual CFR as at 31st March 2014 was £272.24m.

4.2.2 Prudential Indicators – "Prudence"

The Prudential Indicators for Treasury Management are shown in Appendix 1 and the Authority is currently operating within the approved limits.

4.2.3 Prudential Indicators – "Affordability"

There is a requirement to analyse and report the capital financing costs, and express those costs as a percentage of the net revenue streams of the Authority. These are identified in Appendix 2 and currently show a projected reduction from the original budget.

4.2.4 Capital Expenditure and Funding

A summary of capital expenditure and funding is attached at Appendix 3 and shows no change against the planned position. Projections assume that budgets will either be fully expended in accordance with budget holder's expectations, or that unspent budgets will be carried forward as slippage into the 2015/16 financial year.

5. EQUALITIES IMPLICATIONS

5.1 This report is for information purposes, so the Council's Equalities Impact Assessment (EqIA) process does not need to be applied.

6. FINANCIAL IMPLICATIONS

6.1 As detailed throughout the report.

7. PERSONNEL IMPLICATIONS

7.1 There are no direct personnel implications arising from this report.

8. CONSULTATIONS

8.1 There are no consultation responses that have not been reflected in this report.

9. RECOMMENDATIONS

9.1 Members are asked to note the contents of this report.

10. REASONS FOR THE RECOMMENDATIONS

10.1 Compliance with the CIPFA "Code of Practice for Treasury Management in the Public Services".

11. STATUTORY POWER

11.1 Local Government Acts 1972 and 2003.

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Appendices:
Appendix 1 – Treasury Management Prudential Indicators – Prudence
Appendix 2 – Capital Finance Prudential Indicators – Affordability
Appendix 3 – Capital Expenditure and Funding