WOKINGHAM BOROUGH COUNCIL

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Treasury Management Strategy

Annual Treasury Management Report 2014-15

Contents

Appendices

1) Introduction and Background

a) The Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2014/15. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

b) During 2014/15 the Executive has received the following reports:

- The annual treasury strategy at its meeting on the 20th February 2014.
- A mid-year treasury update report at its meeting on the 29th January 2015.
- This report provides the annual review following the end of the year describing the activity compared to the strategy.

The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is, therefore, 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 Council confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Audit Committee before they were reported to the full Council.

This report summarises the following:-

- Capital activity during the year;
- Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement);
- The actual prudential and treasury indicators;
- Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances;
- Summary of interest rate movements in the year;
- Detailed debt activity;
- Detailed investment activity

2) The Council's Capital Expenditure and Financing 2014/15

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, revenue contributions etc.), which has no resultant impact on the Council's borrowing need or:
- Funded by borrowing (Internal or External).

The actual capital expenditure forms one of the required prudential indicators. The tables below show the actual capital expenditure.

General Fund	2013 /14 Actual £'000	2014/15 Budget £'000	2014/15 Actual £'000
Capital expenditure	39,374	88,018	38,774
Financed in year	(33,822)	(55,790)	(28,218)
Unfinanced Capital Expenditure	5,552	32,228	10,556

Note: The variance between actual and budget was due to in the main, slippage in the additional places for schools programme, Wokingham Housing Limited and several large transport infrastructure schemes.

HRA	2013 /14 Actual £'000	2014/15 Budget £'000	2014/15 Actual £'000
Capital expenditure	4,736	7,636	6,561
Financed in year	(4,736)	(7,636)	(6,561)
Unfinanced Capital Expenditure	0	0	0

Note: The variance between actual and budget was due to a large increase in the programme from previous years and capacity issues.

3) The Council's Overall Borrowing Need

The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's indebtedness. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represents the 2014/15 unfinanced capital expenditure (see tables on previous page), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the Government, through the Public Works Loan Board [PWLB] or the money markets), or utilising temporary cash resources within the Council.

The Council's (non HRA) underlying borrowing need (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-Housing Revenue Account (HRA) borrowing need (there is no statutory requirement to reduce the HRA CFR). This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

The total CFR can also be reduced by:

- The application of additional capital financing resources (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

The Council's 2014/15 MRP Policy (as required by Communities and Local Government (CLG) Guidance) was approved as part of the Treasury Management Strategy Report for 2014/15 on 20th February 2014.

The Council's CFR for the year is shown below, and represents a key prudential indicator. It includes PFI and leasing schemes on the balance sheet, which increase the Council's borrowing need. However no borrowing is actually required against these schemes as a borrowing facility is included in the contract.

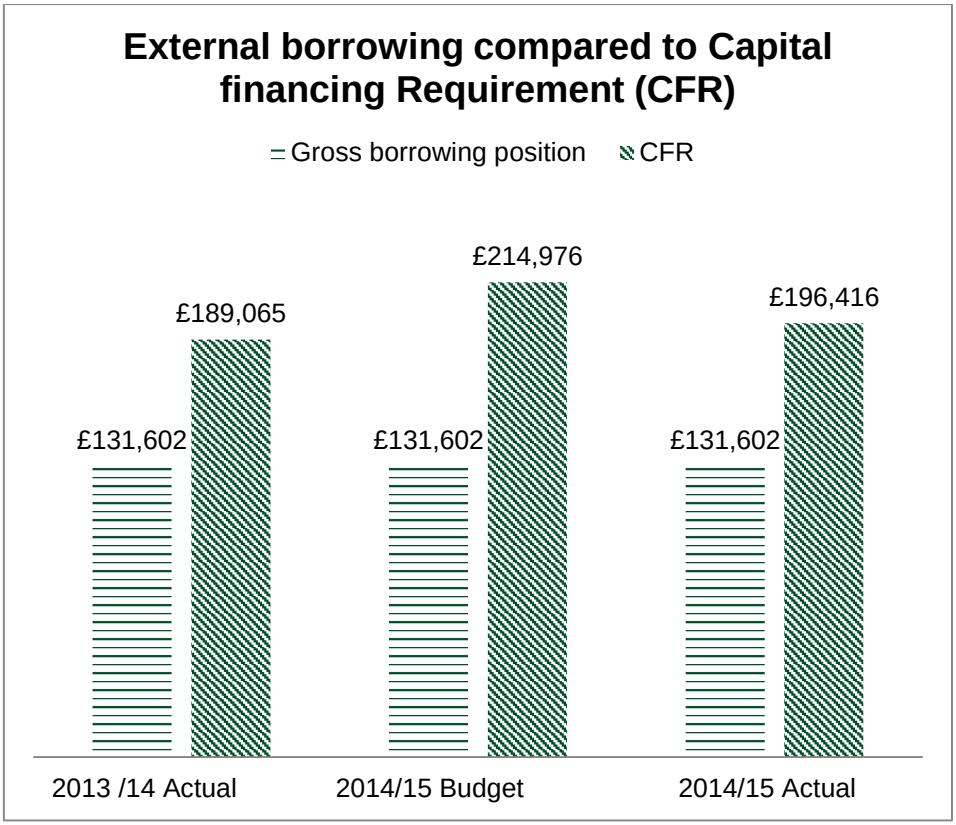
CFR: General Fund	2013 /14 Actual £'000	2014/15 Budget £'000	2014/15 Actual £'000
Opening balance	93,134	99,506	95,255
Add unfinanced capital expenditure (as above)	5,551	24,950	10,556
Less MRP/VRP*	(3,200)	(3,141)	(3,024)
Less PFI & finance lease repayments	(230)	(215)	(247)
Closing balance	95,255	121,100	102,540

Note: The variance between actual and budget was due to good financial management with schemes which were originally planned to be funded by borrowing and have been funded by other sources of funding (S106, New grants) and slippage in large schemes.

CFR : HRA	2013 /14 Actual £'000	2014/15 Budget £'000	2014/15 Actual £'000
Opening balance	95,952	93,876	93,876
Add unfinanced capital expenditure (as above)	0	0	0
Repayment of Loan Principle	(2,076)	0	0
Closing balance	93,876	93,876	93,876

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 and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (plus the estimates of any additional capital financing requirement for the current and next two financial years). This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs. The bar chart below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.



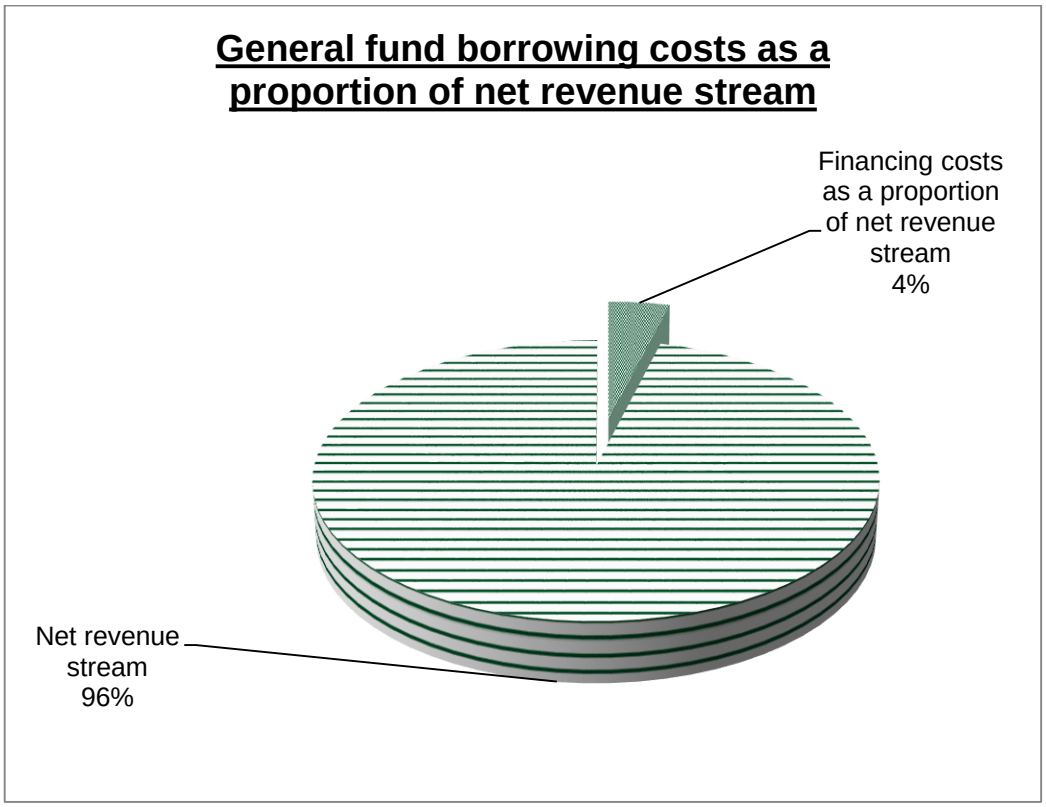
The authorised limit is the "affordable borrowing limit" required by section 3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level.

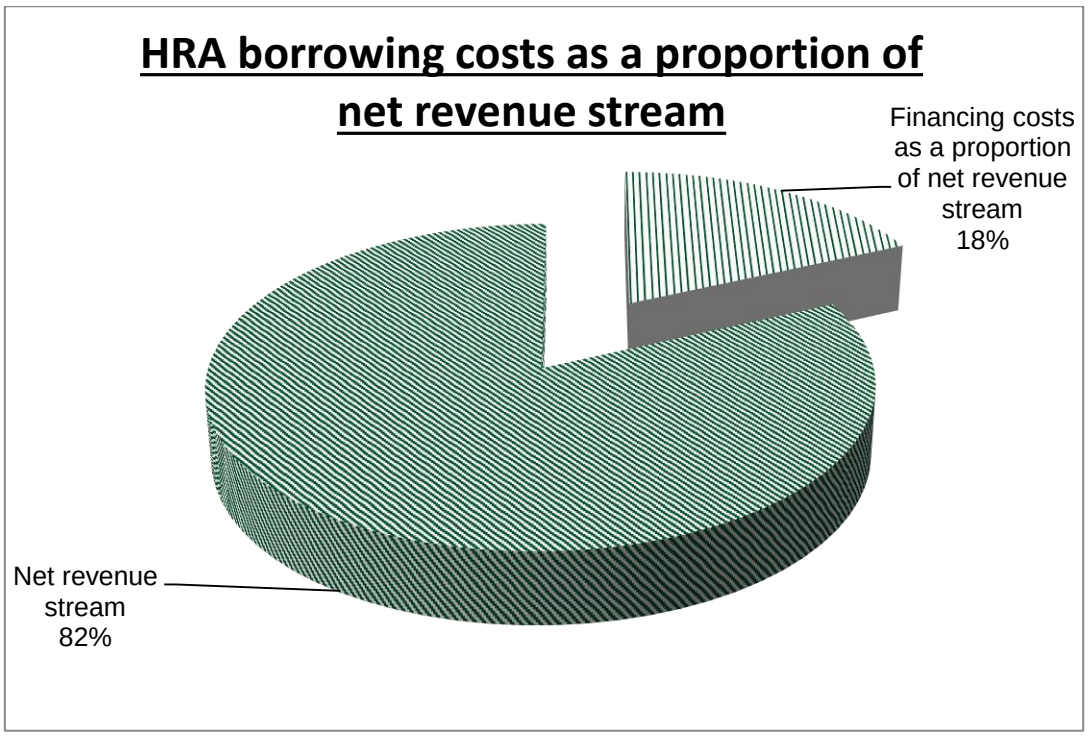
The operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary is acceptable subject to the authorised limit not being breached.

The table below demonstrates that during 2014/15 the Council has maintained gross borrowing within its authorised limit and operational boundary.

	2014/15 £'000	2014/15 Actual £'000	Variance £'000
Authorised limit	**223,000**	**131,602**	**91,398**
Operational boundary	**200,000**	**131,602**	**68,398**

Actual financing costs as a proportion of net revenue stream - this indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream. (see tables below)





4) Treasury Position as at 31st March 2015

The Council's debt and investment position is organised by the treasury management service 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 summary, and through officer activity detailed in the Council's Treasury Management Practices. At the beginning and the end of 2014/15 the Council's treasury (excluding borrowing by PFI and finance leases) position was as follows:

General fund	31 March 2014 Principal £'000	Rate/ Return %	31 March 2015 Principal £'000	Rate/ Return %
Fixed rate funding:	23,151		23,151	
-PWLB	23,031	4.49%	23,031	4.49%
-Market				
-Local Enterprise Partnership (interest free)	120	0.00%	120	0.00%
Variable rate funding:	23,433		23,433	
-PWLB	0			
-Market	23,433	4.28%	23,433	4.27%
Total debt	46,584		46,584	

HRA	31 March 2014 Principal £'000	Rate/ Return %	31 March 2015 Principal £'000	Rate/ Return %
Fixed rate funding:	84,451		84,451	
-PWLB	84,451	2.85%	84,451	2.85%
-Market				
Variable rate funding:	567		567	
-PWLB	0			
-Market	567	4.28%	567	4.28%
Total debt	85,018		85,018	

Average return on Investments (Cumulative)	1st Qtr %	2nd Qtr %	3rd Qtr %	4th Qtr %
Scottish Widows Investment Partnership	0.19%	0.44%	0.68%	0.82%
Royal London Asset Management	0.05%	0.18%	0.32%	0.44%
In-house*	0.91%	1.82%	2.74%	3.66%
Total (Weighted Average)	0.38%	0.81%	1.25%	1.64%

'*This includes internal loans to the HRA and WBC companies (see appendix B)

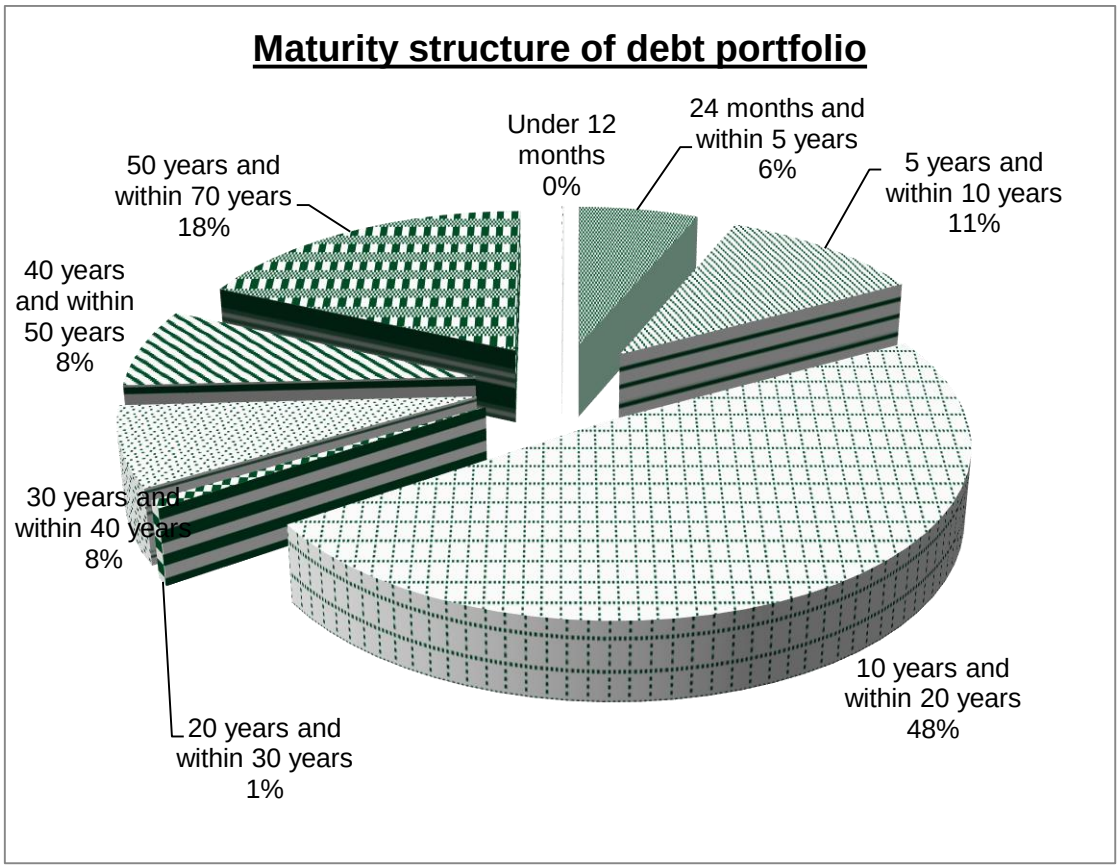
Portfolio Valuation as at 31 March 2015

Portfolio Valuation as at 31 March 2015 (completed by Capita Asset Services)	Nominal / Principle £'000	Fair Value £'000
Investments		
Fixed Term Deposits	37,000	37,117
Total	37,000	37,117
External Debt		
LOBO loan - Fixed rate	24,000	30,984
PWLB loan - Maturity	107,482	132,454
Local Enterprise Partnership loan	120	120
Total	131,602	163,558

* Fair value is a rational and unbiased estimate of the potential market price of goods/services.

The purpose of the valuation is to evaluate quantitatively the authority's financial position and performance with regard to each class of financial instrument, and also to indicate the extent of the authority's risk exposure arising as a result of these transactions.

The maturity structure of the debt portfolio was as follows:



The maturity structure of the investment portfolio was as follows:

	2013/14 Actual £'000	2014/15 Budget £'000	2014/15 Actual £'000
Investments			
Longer than 1 year	**0**	**10,000**	**0**
Under 1 year	**57,243**	**40,000**	**59,735**
Total	**57,243**	**50,000**	**59,735**

Note: The variance between actual and budget was due to fluctuation of Income being received (including section 106) and fluctuation of payments. (The re-profiling of the capital programme).

The exposure to fixed and variable rates was as follows:

	2013/14 Actual £'000	2014/15 Budget £'000	2014/15 Actual £'000
Interest rate exposures: Debt			
Upper limit on fixed rate exposures - Net Position	**107,602**	**180,000**	**107,602**
Upper limit on variable rate exposures - net position	**24,000**	**40,000**	**24,000**

Note: The variance between actual and budget was due, in the main, to the Town centre slippage (Anticipated loan not required)

	2013/14 Actual £'000	2014/15 Budget £'000	2014/15 Actual £'000
Interest rate exposures: Investment			
Upper limit on fixed rate exposures - Net Position	**(42,800)**	**(80,000)**	**(48,867)**
Upper limit on variable rate exposures - net position	**(14,443)**	**(40,000)**	**(9,546)**

Note: The actuals fluctuate during the year depending of the cash flow available for investment.

5) The Treasury Strategy for 2014/15

The expectation for interest rates within the strategy for 2014/15 anticipated low but rising Bank Rate (starting in quarter 1 of 2015), and gradual rises in medium and longer term fixed borrowing rates during 2014/15. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period. Continued uncertainty in the aftermath of the 2008 financial crisis promoted a cautious approach, whereby investments would continue to be dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

In this scenario, the treasury strategy was to postpone external borrowing to avoid the cost of holding higher levels of investments and to reduce counterparty risk. This is demonstrated by an increase of 2.9% since 2014/15. Internal borrowing as at 31st March 2015 stands at 28.4% of the CFR. (See appendix B)

6) The Economy and Interest Rates

The original market expectation at the beginning of 2014/15 was for the first increase in Bank Rate to occur in quarter 1 2015 as the unemployment rate had fallen much faster than expected through the Bank of England's initial forward guidance target of 7%. In May, 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 the Bank halved its forecast

for pay inflation in 2014 from 2.5% to 1.25%. Expectations for the first increase in Bank Rate therefore started to recede as growth was still heavily dependent on buoyant consumer demand. During the second half of 2014 financial markets were caught out by a halving of the oil price and the collapse of the peg between the Swiss franc and 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. By the end of 2014, it was clear that inflation in the UK was going to head towards zero in 2015 and possibly even turn negative. In turn, this made it clear that the Monetary Policy Committee (MPC) would have great difficulty in starting to raise 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.

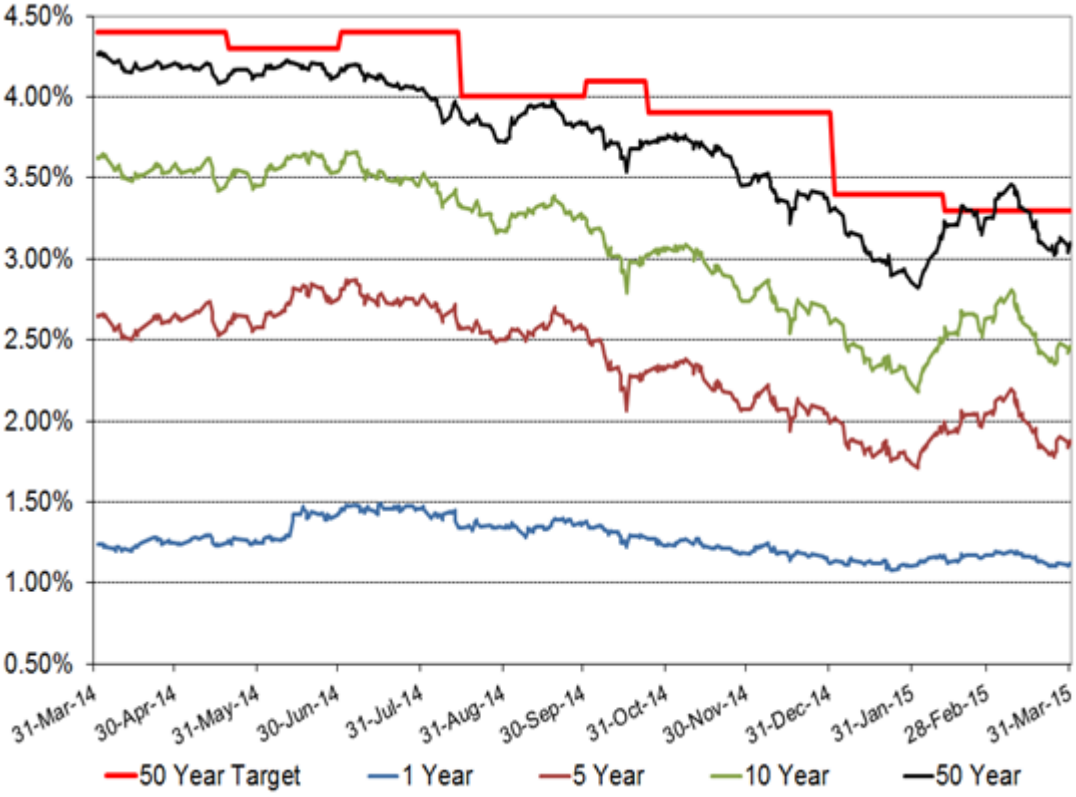
Gilt yields were on a falling trend for much of the last eight months of 2014/15 but were then pulled in different directions by increasing fears after the anti-austerity parties won power in Greece in January; developments since then have increased fears that Greece could be heading for an exit from the euro. While the direct effects of this would be manageable by the European Union (EU) and European Central Bank (ECB), it is very hard to quantify quite what the potential knock on effects would be on other countries in the Eurozone (EZ) once the so called impossibility of a country leaving the EZ had been disproved. Another downward pressure on gilt yields was the announcement in January that the ECB would start a major programme of quantitative easing, purchasing EZ government and other debt in March. On the other hand, strong growth in the 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 rate, probably by the end of 2015. 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 UK general election.

The Funding for Lending Scheme, announced in July 2012, resulted in a flood of cheap credit being made available to banks which then resulted in money market investment rates falling drastically in the second half of that year and continuing throughout 2014/15.

The UK coalition Government maintained its tight fiscal policy stance but recent strong economic growth and falling gilt yields led to a reduction in the forecasts for total borrowing in the March budget.

7) Borrowing Rates in 2014/15

The graphs for PWLB certainty maturity rates below, show, for a selection of maturity periods, the high and low points in rates, the average rates, spreads and individual rates at the start and the end of the financial year.



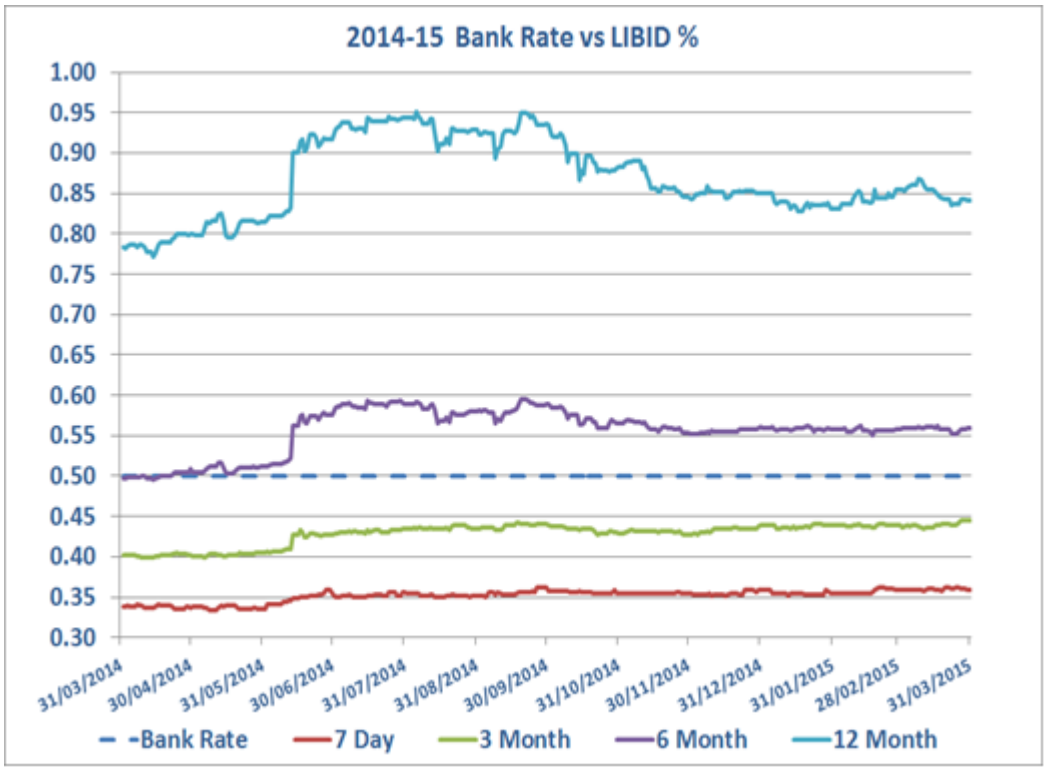
8) Borrowing Outturn for 2014/15

Borrowing – No New loans were undertaken

Repayments – No repayments were actioned in 2014/15

9) Investment Rates in 2014

Bank Rate remained at its historic low of 0.5% throughout the year; it has now remained unchanged for six years. Market expectations as to the timing of the start of monetary tightening started the year at quarter 1 2015 but then moved back to around quarter 3 2016 by the end of the year. Deposit rates remained depressed during the whole of the year, primarily due to the effects of the Funding for Lending Scheme.



10) Investment Outturn for 2014/15

The Council's investment policy is governed by CLG guidance, which was been implemented in the annual investment strategy approved by the Council on 20th February 2014. This policy sets out the approach for choosing investment 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.).

The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

Resources – the Council's cash balances comprise revenue and capital resources and cash flow monies. The Council's core cash resources comprised as follows:

	31-Mar-2014 £'000	31-Mar-2015 £'000
Balance Sheet Resources (£m)		
Balances-(General Fund, Housing Revenue Account and Dedicated Schools Grant)	18,099	16,230
Earmarked reserves	42,039	50,701
Provisions	4,609	4,546
Usable capital receipts	6,830	8,459
Total	71,577	79,936

Interest received from Investments held by the Council

	2014-15 Budget As per the TMSS £'000	2014/15 Actual £'000	%
Interest on investments			
RLAM		64	7.4%
Aberdeen Asset Management *		105	12.1%
In House **		696	80.4%
Total	726	865	100%

Note:* Aberdeen asset Management formerly known as Scottish Widows Investment Partnership (SWIP)

Note ** includes internal loans to Wokingham Housing Limited and HRA

11) Performance Measurement

One of the key requirements in the Code is the formal introduction of performance measurement relating to investments, debt and capital financing activities. Whilst investment performance criteria have been well developed and universally accepted, debt performance indicators continue to be a more problematic area with the traditional average portfolio rate of interest acting as the main guide. The Council's performance indicators were set out in the Annual Treasury Management Strategy.