Annual Treasury Management Report 2015/16

1. Introduction

This 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 2015/16. 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).

During 2015/16 the minimum reporting requirements were that the full Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 24/03/2015)
- a mid-year (minimum) treasury update report (Council 08/12/2015)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

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.

This 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 Governance and Audit Committee before they were reported to the full Council.

2.1 The Economy and Interest Rates

Market expectations for the first increase in Bank Rate moved considerably during 2015/16, starting at quarter 3 2015 but soon moving back to quarter 1 2016. However, by the end of the year, market expectations had moved back radically to quarter 2 2018 due to many fears including concerns that China's economic growth could be heading towards a hard landing; the potential destabilisation of some emerging market countries particularly exposed to the Chinese economic slowdown, and the continuation of the collapse in oil prices during 2015 together with continuing Eurozone growth uncertainties.

These concerns have caused sharp market volatility in equity prices during the year with corresponding impacts on bond prices and bond yields due to safe haven flows. Bank Rate, therefore, remained unchanged at 0.5% for the seventh successive year. Economic growth (Gross Domestic Product) in 2015/16 has been disappointing with growth falling steadily from an annual rate of 2.9% in quarter 1 2015 to 2.1% in quarter 4.

The sharp volatility in equity markets during the year was reflected in sharp volatility in bond yields. However, the overall dominant trend in bond yields since

July 2015 has been for yields to fall to historically low levels as forecasts for inflation have repeatedly been revised downwards and expectations of increases in central rates have been pushed back. In addition, a notable trend in the year was that several central banks introduced negative interest rates as a measure to stimulate the creation of credit and hence economic growth.

The European Central Bank commenced a full blown quantitative easing programme of purchases of Eurozone government and other bonds starting in March at €60bn per month. This put downward pressure on Eurozone bond yields. There was a further increase in this programme of QE in December 2015.

As for America, the economy has continued to grow healthily on the back of resilient consumer demand. The first increase in the central rate occurred in December 2015 since when there has been a return to caution as to the speed of further increases due to concerns around the risks to world growth.

The UK elected a majority Conservative Government in May 2015, removing one potential concern but introducing another due to the promise of a referendum on the UK remaining part of the EU. The government maintained its tight fiscal policy stance but the more recent downturn in expectations for economic growth has made it more difficult to return the public sector net borrowing to a balanced annual position within the period of this parliament.

2.2 Overall Treasury Position as at 31 March 2016

At the beginning and the end of 2015/16 the Council's treasury (including borrowing by Public Finance Initiative and finance leases) position was as follows:

TABLE 1	31 March 2015 Principal	31st March 2016
Total debt	**£391m**	**£336m**
PFI & other Finance Leases **Total Debt** **CFR**	**204m** **595m** **£679m**	**£196m** **£532m** **£666m**
Over / (under) borrowing	**(£84m)**	**(£134m)**
Total investments	**£112.3m**	**£43m**
Net debt	**£482.7m**	**£489m**

2.3 The Strategy for 2015/16

The expectation for interest rates within the treasury management strategy for 2015/16 anticipated a low but rising Bank Rate, (starting in quarter 1 of 2016), and gradual rises in medium and longer term fixed borrowing rates during 2016/17. 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 borrowing to avoid the cost of holding higher levels of investments and to reduce counterparty risk.

The sharp volatility in equity markets during the year was reflected in sharp volatility in bond yields. However, the overall dominant trend in bond yields since July 2015 has been for yields to fall to historically low levels as forecasts for inflation have repeatedly been revised downwards and expectations of increases in central rates have been pushed back.

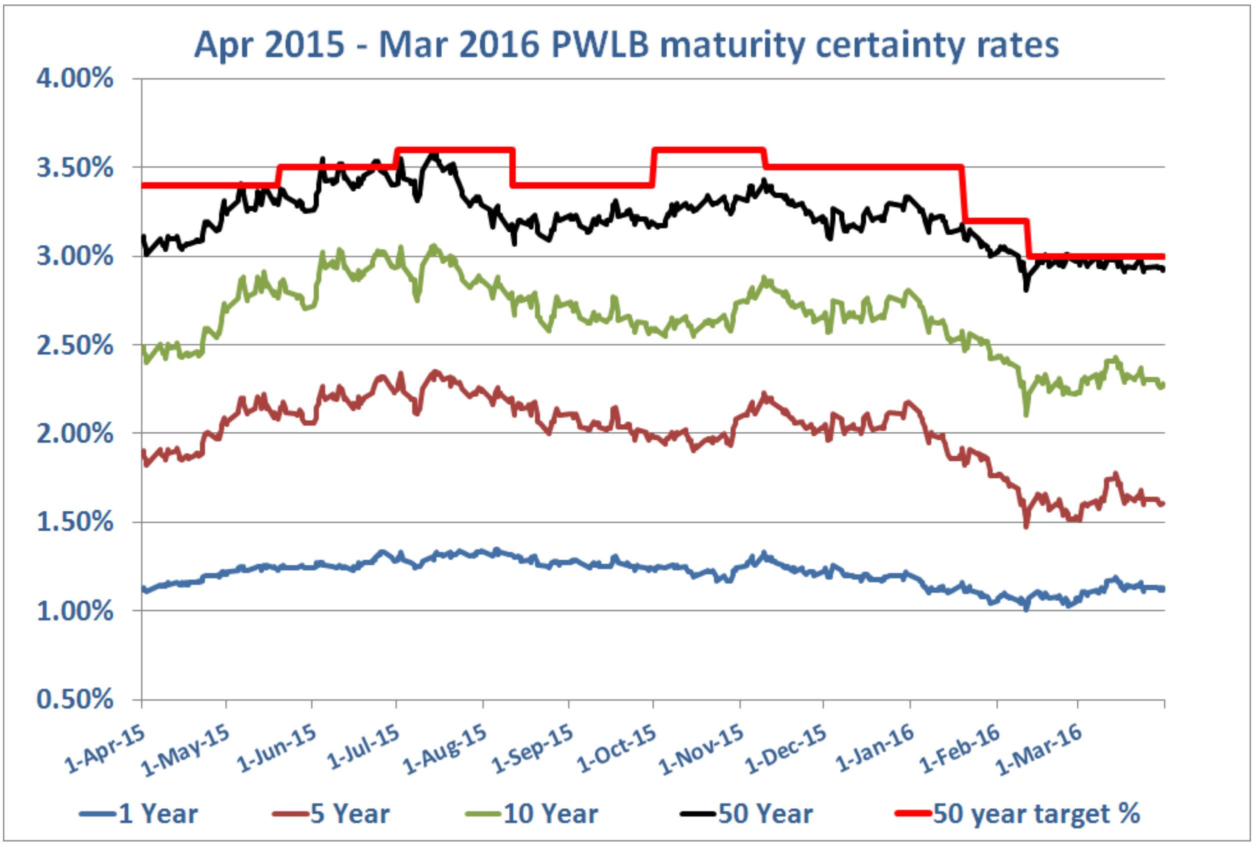
2.4 The Borrowing Requirement and Debt

The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).The CFR represents the sum of historic borrowing required to fund the Councils capital investment less any provision made for the repayment of that debt through the Minimum Revenue Provision (MRP).This does not necessarily equate to external borrowing as the Council can use its own cash balances to fund its borrowing requirements. Where this occurs it is sometimes referred to as being "under borrowed" as if those cash balances are exhausted the Council would need to go out and borrow externally.

	31 March 2015 Actual	31 March 2016 Budget	31 March 2016 Actual
Capital Financing Requirement	£679m	£696m	£666m

2.5 Borrowing Rates in 2015/16

Public Works Loan Board certainty maturity borrowing rates - the graph below shows how PWLB certainty rates have fallen to historically very low levels during the year. The PWLB is the main source of borrowing for the council.



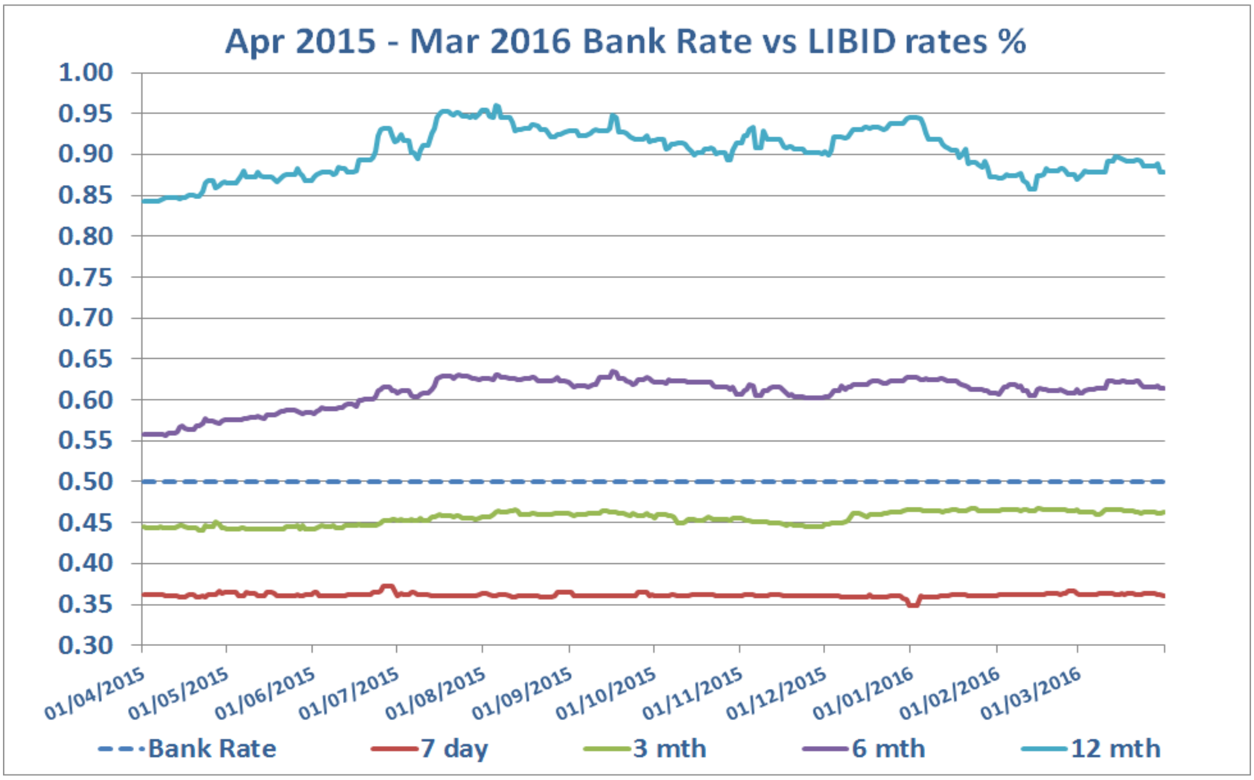
2.6 Borrowing Outturn for 2015/16

Due to investment concerns, both counterparty risk and low investment returns, no borrowing was undertaken during the year.

No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

Repayments
On the 27/04/15 the Council repaid £53.6m of debt which matured on that date. This reduced the debt balance from £384m to £330.4m.

2.7 Investment Rates in 2015/16



Bank Rate remained at its historic low of 0.5% throughout the year; it has now remained unchanged for seven years. Market expectations as to the timing of the start of monetary tightening started the year at quarter 1 2016 but then moved back to around quarter 2 2018 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 and due to the continuing weak expectations as to when Bank Rate would start rising.

2.8 Investment Outturn for 2015/16

Investment Policy – the Council's investment policy is governed by CLG guidance, which has been implemented in the annual investment strategy approved by the Council on 12th October 2010. 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 centrally held investments complied with the approved strategy, but the schools balances with Barclays and Lloyds were above the Treasury counterparty limits.
Investments held by the Council - the Council maintained an average balance of £94.2m of internally managed funds. The internally managed funds earned an average rate of return of 0.62%.The comparable performance indicator is the average 7-day LIBID rate which was 0.36%.

2.9 Other Issues

None

3. Other considerations

None

4. Financial and Resources Appraisal

The financial implications are set out in section 2 of this report

5.Risk Management and Governance Issues

None

6. Legal Appraisal

Any relevant legal considerations are set out in the report

7. Other Implications

7.1 Equal Rights implications – no direct implications
7.2 Sustainability implications – no direct implications
7.3 Green house Gas Emissions Impact – no direct implications
7.4 Community safety implications – no direct implications
7.5 Human Rights Act – no diret implications
7.6 Trade Unions – no direct implications
7.7 Ward Implications – no direct implications

8. Not for publications documents – none

9 Recommendations

9.1. That the report be noted and referred to Council for adoption.

10.Appendices

1.Prudential Indicators
2.Treasury Management Indicators

11. Background Documents

Treasury Management Practices
Treasury Management Schedules

Appendix 1: Prudential and treasury indicators

1. PRUDENTIAL INDICATORS	**2014/15**	**2015/16**	**2015/16**
Extract from budget and rent setting report	**actual**	**original**	**actual**
	£m	**£m**	**£m**
Capital Expenditure	**£114m**	**£86m**	**£70m**
Ratio of financing costs to net revenue stream	**15.5%**	**15.4%**	**14.4%**
Gross borrowing requirement General Fund	£391m	£349m	£336m
CFR	£679m	£696m	£666m
Incremental impact of capital investment decisions	**£ p**	**£ p**	**£ p**
Increase in council tax (band D) per annum	£0.00	0.00	0.00

2. TREASURY MANAGEMENT INDICATORS	2014/15	2015/16	2015/16
	actual	original	actual
	£m	£m	£m
Authorised Limit for external debt -			
borrowing	£391m	£420m	£336m
other long term liabilities	£204m	£240m	£196m
TOTAL	£595m	£660m	£532m
Operational Boundary for external debt -			
borrowing	£391m	£380m	£336m
other long term liabilities	£204m	£220m	£196m
TOTAL	£595m	£600m	£532m
Upper limit for fixed interest rate exposure	+175 %	+175 %	+175%
Upper limit for variable rate exposure			
Upper limit for variable rate exposure	+20 %	+20%	+20%
Upper limit for total principal sums invested for over 364 days (per maturity date)	£40m	£40m	£40m

Maturity structure of fixed rate borrowing during 2015/16	upper limit	lower limit
under 12 months	20%	0%
12 months and within 24 months	20%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	50%	0%
10 years and above	90%	20%