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Report of the Director of Finance to the meeting of Governance and Audit Committee to be held on 30 October 2015.

Subject:

V

Annual Treasury Management Report 2014/2015.

Summary statement:

This report shows the Council's Treasury Management activities for the year ending 31 March 2015.

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Portfolio:
Leader

Overview & Scrutiny Area:

Corporate

Annual Treasury Management 2014/15

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 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).

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

- an annual treasury strategy in advance of the year (Council 09/12/2014)
- a mid-year (minimum) treasury update report (Council 09/12/2014)
- 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 also 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.

2.0 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 the 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 was going to do too little too late to ward off the threat of deflation and recession in the Eurozone. Consequently in mid-October, financial markets fell sharply before recovering a week later. 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 would have great difficulty in raising 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.

UK government yields were on a falling trend for much of the last eight months of 2014/15 but were then pulled in different directions due to uncertainty after the anti-austerity parties won power in Greece in January. Since then fears have increased that Greece could be heading for an exit from the euro. While the direct effects of this would be manageable by the European Union and European Central Bank, it is very hard to quantify quite what the potential knock on effects would be on other countries in the Eurozone once the so called impossibility of a country leaving the Eurozone had been disproved. Another downward pressure on UK government yield was the announcement in January that the European Central Bank would start a major programme of quantitative easing, purchasing Eurozone 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 likely to follow it after strong growth over 2013 and 2014 and good prospects for a continuation into 2015 and beyond, although the general election in May has added political risk to the mix.

2.1 Overall Treasury Position as at 31 March 2015

At the beginning and the end of 2014/15 the Council's treasury position was as follows:

TABLE 1	31 March 2014 Principal	31 March 2015 Principal
Total debt	***£418m***	***£391m***
PFI & other Finance Leases	***£212m***	***£204m***
Total Debt	***£630m***	***£595m***
CFR	***£688m***	***£679m***
Over / (under) borrowing	***(£58m)***	***(£84m)***
Total investments	***£138m***	***£112.3m***
Net debt	**£492m**	**£482.7m**

2.2 The 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 borrowing to avoid the cost of holding higher levels of investments and to reduce counterparty risk.

The actual movement in government yields meant that Public Works Loan Board rates saw little overall change during the first four months of the year but there was then a downward trend for the rest of the year with a partial reversal during February.

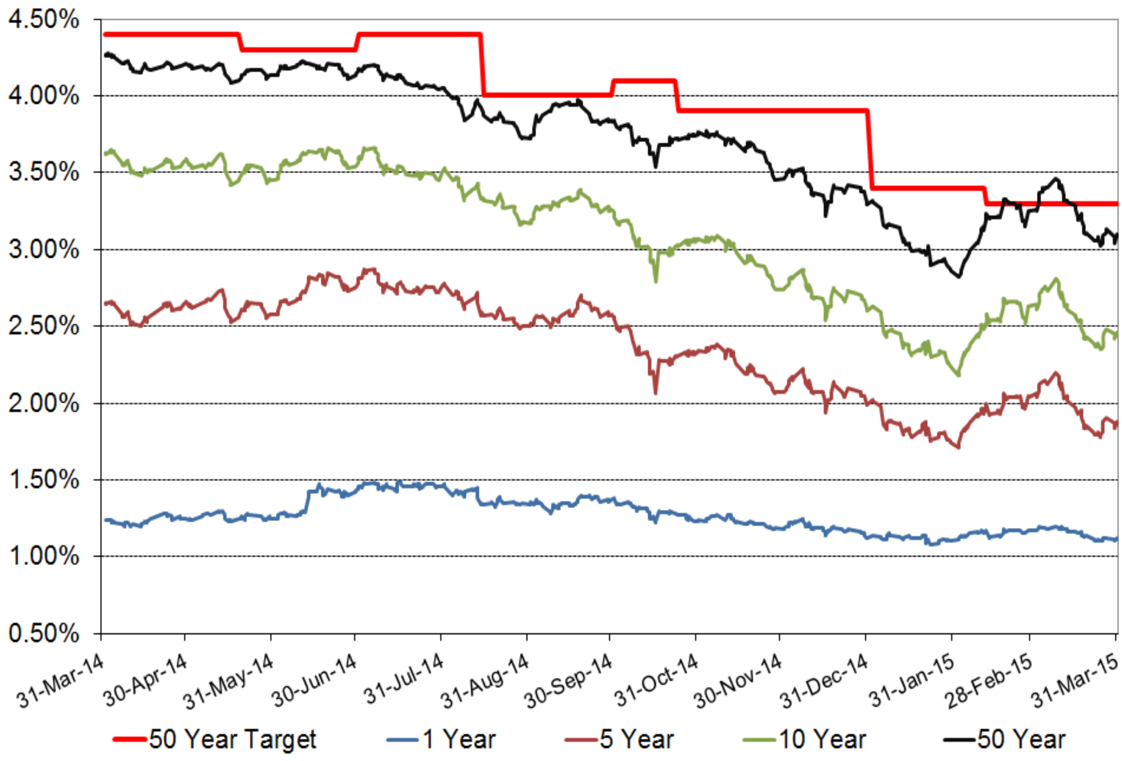
2.3 The Borrowing Requirement and Debt

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 Council's 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 2014 Actual £m	31 March 2015 Budget £m	31 March 2015 Actual £m
CFR General Fund (£m)	688m	707m	679m

2.4 Borrowing Rates in 2014/15

PWLB borrowing rates - the graph below shows how PWLB certainty rates have fallen to historically very low levels during the year.



2.5 Borrowing Outturn for 2014/15

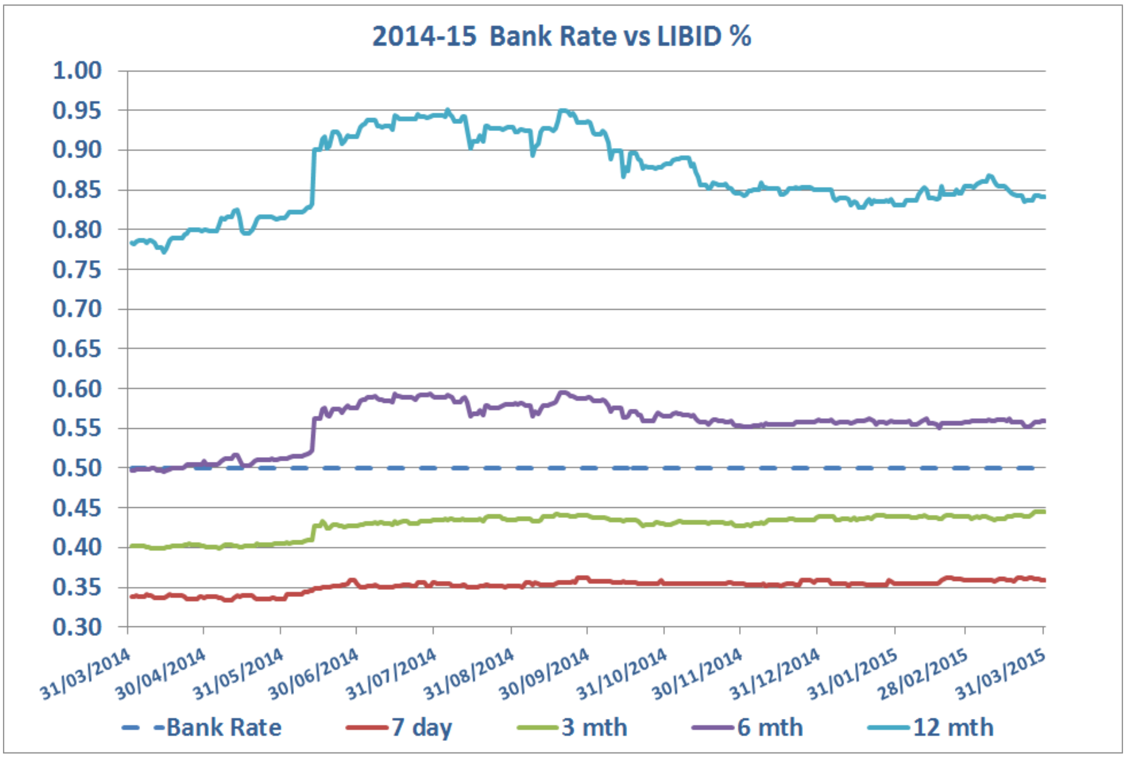
Due to investment concerns, both counterparty risk and low investment returns, no borrowing was undertaken during the year.

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 24/11/14 the Council repaid £25.9m of debt which matured on that date. This reduced the debt balance from £409.8m to £384m.

2.6 Investment Rates in 2014/15

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.



2.7 Investment Outturn for 2014/15

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

Investments held by the Council - the Council maintained an average balance of £138.6m of internally managed funds. The internally managed funds earned an average rate of return of 0.6%. The comparable performance indicator is the average 7-day LIBID rate , which was 0.35%. This compares with a budget assumption of £100m investment balances earning an average rate of 0.5%.

2.8. Other Issues

No other issues

3. Other considerations

3.1 None

4 Financial and Resources Appraisal

4.1 The financial implications are set out in Section 2

5. Risk Management and Governance Issues

5.1 None

6. Legal Implications

6.1 Any relevant legal considerations are set out in the report.

7. Other implications

7.1 Equal & Diversity – no direct implications

7.2 Sustainability implications- no direct implications

7.3 Green Gas Emissions impact – no direct implications

7.4 Community Safety Implications – no direct implications

7.5 Human Rights Act – no direct implications

7.6 Trade Unions – no direct implications

7.7 Ward Implications – none

8. Not for publication documents

8.1 None

9. Recommendations

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

10. Appendices

Appendix 1 Prudential and Treasury Indicators

11. Background Documents

Treasury Management Practices

Treasury Management Schedules

Appendix 1: Prudential and treasury indicators

1. PRUDENTIAL INDICATORS	**2013/14**	**2014/15**	**2014/15**
	actual	**original**	**actual**
	£m	**£m**	**£m**
Capital Expenditure	£92m	£125m	£114m
Gross Borrowing	£418m	£418m	£391m
Ratio of financing costs to net revenue stream	13.8%	14.7%	15.5%
CFR	£688m	£707m	£679m

2. TREASURY MANAGEMENT INDICATORS	**2013/14**	**2014/15**	**2014/15**
	actual	**original**	**actual**
	£m	**£m**	**£m**
Authorised Limit for external debt -			
borrowing	£510m	£460m	£391m
other long term liabilities	£280m	£260m	£204m
TOTAL	£790m	£720m	£595m
Operational Boundary for external debt -			
borrowing	£490m	£440m	£391m
other long term liabilities	£270m	£250m	£204m
TOTAL	£760m	£690m	£595m
Upper limit for fixed interest rate exposure	+175%	+175%	+175%
Upper limit for variable rate exposure	+20%	+20%	+20%
Upper limit for total principal sums invested for over 364 /365days (per maturity date)	£40m	£40m	£0m

Maturity structure of fixed rate borrowing during 2014/15	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%