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PR.13 15/16
Corporate Policy and Resources Committee
30 July 2015

Subject: Annual Report on the Treasury Management Service and Actual Prudential and Treasury Indicators 2014/15

Report by:	Financial Services Team Manager (Deputy S151) Tracey Bircumshaw
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Purpose / Summary:	This annual treasury report is a requirement of the Council's reporting procedures. It covers the treasury activity during 2014/15 and the actual Prudential Indicators for 2014/15.

RECOMMENDATION(S):

That Members accept the Annual Treasury Management Report for 2014/15 and recommend to Council the approval of the actual 2014/15 Prudential and Treasury Indicators contained therein.

IMPLICATIONS

Legal: None arising as a result of this report.

Financial: FIN/43/16: None arising from this report.

Staffing: None arising as a result of this report.

Equality and Diversity including Human Rights: None arising as a result of this report.

Risk Assessment: This is a monitoring report only.

Climate Related Risks and Opportunities: This is a monitoring report only.

Title and Location of any Background Papers used in the preparation of this report:

Call in and Urgency:

Is the decision one which Rule 14.7 of the Scrutiny Procedure Rules apply?

i.e. is the report exempt from being called in due to urgency (in consultation with C&I chairman)	**Yes**		**No**	**x**

Key Decision:

A matter which affects two or more wards, or has significant financial implications	**Yes**		**No**	**x**

Background

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 indictors 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 the full Council should receive the following reports:

- an Annual Treasury Strategy in advance of the year - Council meeting held 03 March 2014
- a Mid-Year (minimum) Treasury Update Report – Council meeting held 06 November 2014
- an Annual Treasury Management Report following the year describing the activity compared to the strategy (this report).

In addition, the Policy and Resources Committee has received quarterly Treasury Management update reports on 04 September 2014, 6 November 2014, 19 February 2015 and 18 June 2015.

The regulatory environment places responsibility on Members for the review and scrutiny of treasury management policy and activities. The 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 Governance and Audit Committee (Annual Investment Strategy) and Policy and Resources Committee (Capital Programme, Mid-Year and Annual Report) before they were reported to the full Council. Member training on treasury management issues was undertaken during the year in January 2015 in order to support Members' scrutiny role.

Executive Summary

During 2014/15, the Council complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

Prudential and treasury indicators	**2013/14 Actual £'000**	**2014/15 Original £'000**	**2014/15 Revised £'000**	**2014/15 Actual £'000**
Capital expenditure	2,251	4,566	3,346	1,711
Capital Financing Requirement:	1,745	4,566	3,346	1,631
Gross Borrowing (Finance Leases)	683	303	303	570
Gross Investments				
• Longer than 1 year	0	0	2,000	2,000
• Under 1 year	15,929	13,195	17,583	16,600
Total	**15,929**	**13,195**	**19,583**	**18,600**
Net borrowing/ (investments)	**(15,246)**	**(12,892)**	**(19,280)**	**(18,030)**

Other prudential and treasury indicators are to be found in the main body of this report. The S151 Officer also confirms that borrowing was only undertaken for a capital purpose and the statutory borrowing limit (the Authorised Limit) was not breached.

The financial year 2014/15 continued with a challenging investment environment as of recent years, namely low investment returns.

1. Introduction

1.1 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 if 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

2.1 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

- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

2.2 The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

General Fund	2013/14 Actual £'000	2014/15 Original £'000	2014/15 Revised Estimate £'000	2014/15 Actual £'000
Capital expenditure	**2,251**	**4,566**	**3,426**	**1,711**
Resourced by:				
Capital receipts	153	2,034	1,336	244
Capital grants / Contributions	1,224	462	381	362
Revenue	780	2,070	1,534	932
Leases	94	0	70	69
S106	0	0	105	104
Unfinanced capital expenditure	**0**	**0**	**0**	**0**

3. The Council's Overall Borrowing Need

3.1 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 table 2.2), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

3.2 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 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.

3.3 **Reducing the CFR** – The Council's 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 borrowing. 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.

3.4 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).

3.5 The Council's 2014/15 MRP Policy (as required by CLG Guidance) was approved as part of the Treasury Management Strategy Report for 2014/15 on 3 March 2014.

3.6 The Council's CFR for the year is shown below, and represents a key prudential indicator. It is made up of £1.065m resulting from changes in capital financing regulations, this effectively represents capital expenditure funded from cash under previous capital financing regulations) and will remain within the CFR for the foreseeable future. As this is a technical accounting adjustment, there is no requirement to repay this amount through the MRP regulations. In addition it includes leasing schemes held on the balance sheet, these increase the Council's borrowing need, however no borrowing is actually required against these schemes as the borrowing facility is included in the contract.

Capital Financing Requirement	31 March 2014 Actual £'000	31 March 2015 Budget £'000	31 March 2015 Revised £'000	31 March 2015 Actual £'000
Opening balance	**1,842**	**1,775**	**1,636**	**1,745**
Adj for previous year financing	1	1	1	0
Add adjustment for the inclusion of on-balance sheet leasing arrangements	94	0	0	69
Less Finance Lease repayments/MRP	(192)	(207)	(207)	(183)
Closing balance	**1,745**	**1,567**	**1,428**	**1,631**

3.7 Borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit.

3.8 **Gross borrowing and the CFR** – 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 (2014/15) plus the estimates of any additional capital financing requirement for the current year (2015/16) and the 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 in 2014/15. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator with the gross borrowing position reflecting outstanding finance leases on vehicles and equipment.

	31 March 2014 Actual £'000	31 March 2015 Original £'000	31 March 2015 Revised £'000	31 March 2015 Actual £'000
Gross borrowing position	**683**	**303**	**303**	**570**
CFR	**1,745**	**1,567**	**1,428**	**1,631**

3.9 **The Authorised Limit** – 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 table below demonstrates that during 2014/15 the Council has maintained gross borrowing within its authorised limit.

3.10 **The Operational Boundary** – 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.

3.11 **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.

	2014/15 £'000
Authorised Limit	**3,000**
Maximum gross borrowing position	**570**
Operational Boundary	**303**
Average gross borrowing position	**627**
Financing costs as a proportion of net revenue stream	**0.25%**

4. Treasury Position as at 31 March 2015

4.1.1 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 position (excluding finance leases) was as follows:

Actual borrowing position	**31 March 2014**		**31 March 2015**	
	Principal £'000	**Average Rate**	**Principal £'000**	**Average Rate**
Fixed Interest Rate Debt	0	0%	0	0%
Variable Interest Rate Debt	0	0%	0	0%
Total Debt	**0**	**0%**	**0**	**0%**
Capital Financing Requirement £'000	**1,745**		**1,631**	
Finance lease liabilities £'000	**683**		**570**	
Over/(under) borrowing £'000	**(1,062)**		**(1,517)**	
Bank and Money Market deposits	**31 March 2014**		**31 March 2015**	
	Principal £'000	**Average Rate**	**Principal £'000**	**Average Rate**
Fixed Interest money market and bank deposits	13,729	0.68%	10,500	0.92%
Variable Interest money market and bank deposits	2,200	0.38%	8,100	1.49%
Total Investments/Cash Equivalents	**15,929**	**1.45%**	**18,600**	**2.41%**
Net borrowing position	**(15,246)**		**(18,030)**	

The maturity of the investment portfolio was as follows:

	31 March 2014 Actual £'000	2014/15 Original limits £'000	31 March 2015 Actual £'000
Investments/Cash Equivalents			
Longer than 1 year	0	0	2,000
Under 1 year	15,929	13,195	16,600
Total	**15,929**	**13,195**	**18,600**

Note: Excludes bank current account balance.

5. The Strategy for 2014/15

5.1 The expectation for interest rates within the strategy for 2015/15 anticipated low but rising Bank Rates (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 gilt yields meant that PWLB 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.

6. The Economy and Interest Rates (Capita Treasury Management Advisors)

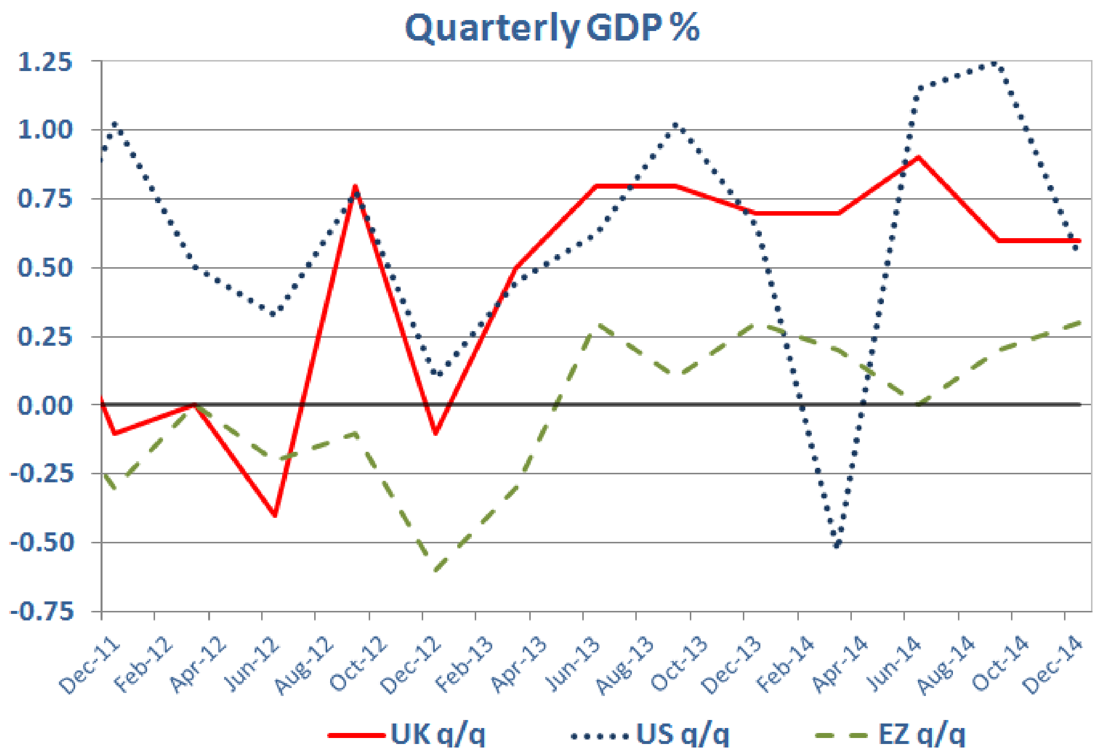
6.1 The original market expectation at the beginning of 2014/15 was for the first increase in Bank Rate to occur in quarter 1 2015 as the unemployment rate had fallen much faster than expected through the Bank of England's initial forward guidance target of 7%. In May, however, the Bank revised its forward 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 ECB was going to do too little too late to ward off the threat of deflation and recession in the Eurozone. In mid-October, financial markets had a major panic for about a week. 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 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.

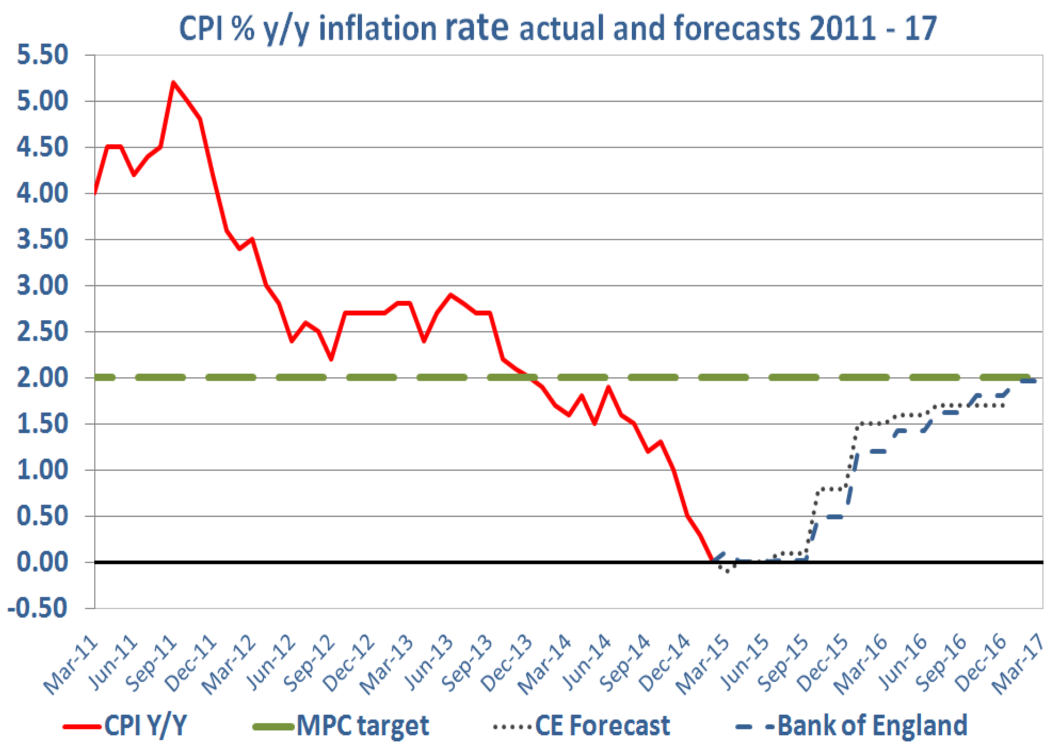
6.2 Gilt yields were on a falling trend for much of the last eight months of 2014/15 but were then pulled in different directions by increasing fears after the anti-austerity parties won power in Greece in January; developments since then have increased fears that Greece could be heading for an exit from the euro. While the direct effects of this would be manageable by the EU and ECB, 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 EZ had been disproved. Another downward pressure on gilt yields was the announcement in January that the ECB would start a major programme of quantitive 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 general election due in May 2015.

6.3 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.

6.3 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.

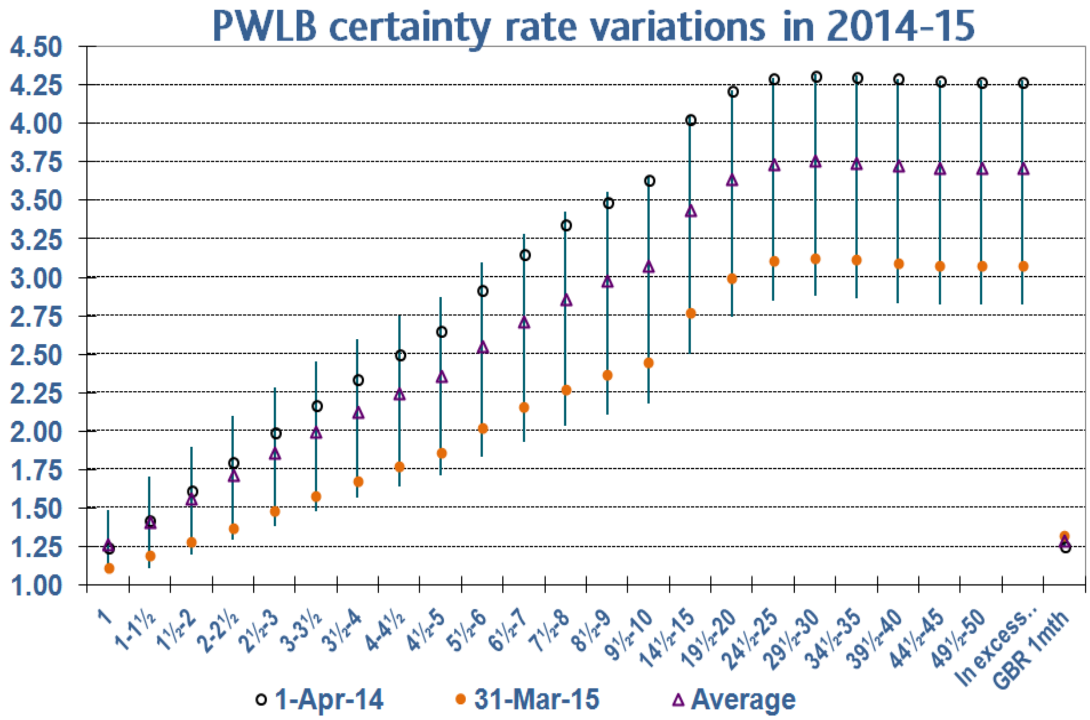
6.4 The EU sovereign debt crisis had subsided since 2012 until the Greek election in January 2015 sparked a resurgence of fears. While the UK banking system has little direct exposure to Greece, it is much more difficlut to quantify quite what effects there would be if contagion from a Greek exit from the euro were to severely impact other major countries in the EZ and cause major damage to their banks.

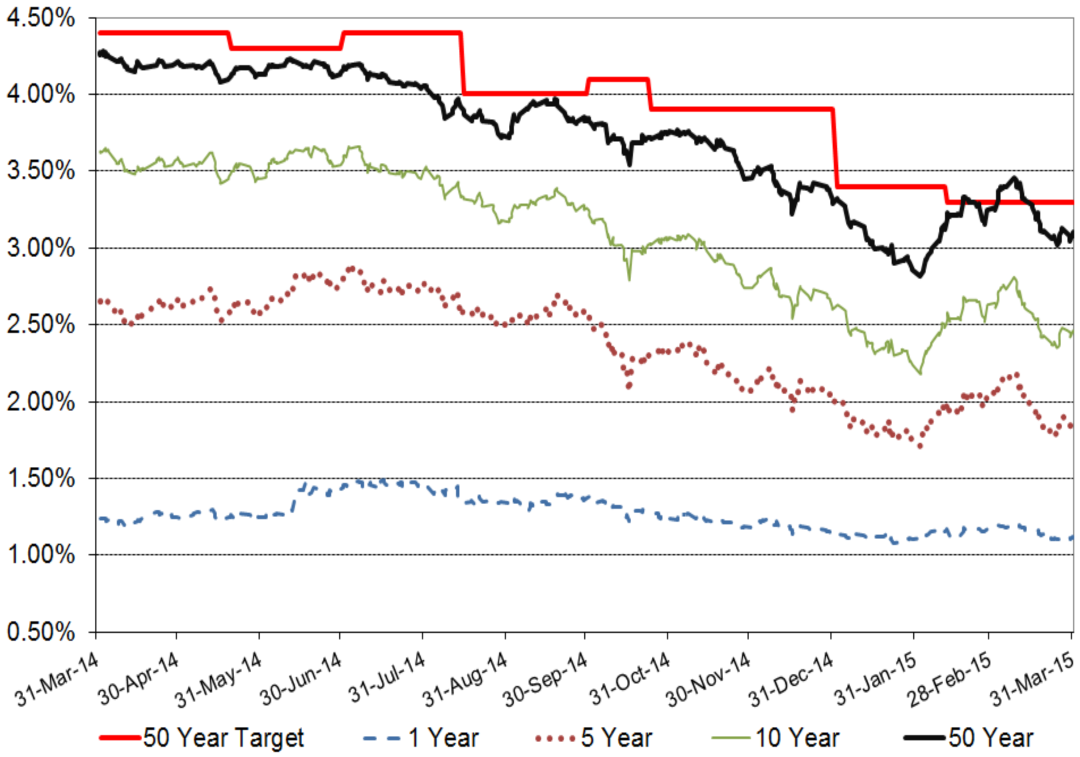




7. Borrowing Rates in 2014/15– (Sector Treasury Management Advisors)

7.1 **PWLB certainty maturity borrowing rates –** the graph and table for PWLB rates below show, for a selection of maturity periods, the average borrowing rates, the high and low points in rates, spreads and individual rates at the start and the end of the financial year.


PWLB certainty rate variations in 2014-15
4.50
4.25
4.00
3.75
3.50
3.25
3.00
2.75
2.50
2.25
2.00
1.75
1.50
1.25
1.00
1
1-1½
1½-2
2-2½
2½-3
3-3½
3½-4
4-4½
4½-5
5½-6
6½-7
7½-8
8½-9
9½-10
14½-15
19½-20
24½-25
29½-30
34½-35
39½-40
44½-45
49½-50
In excess..
GBR 1mth
1-Apr-14
31-Mar-15
Average

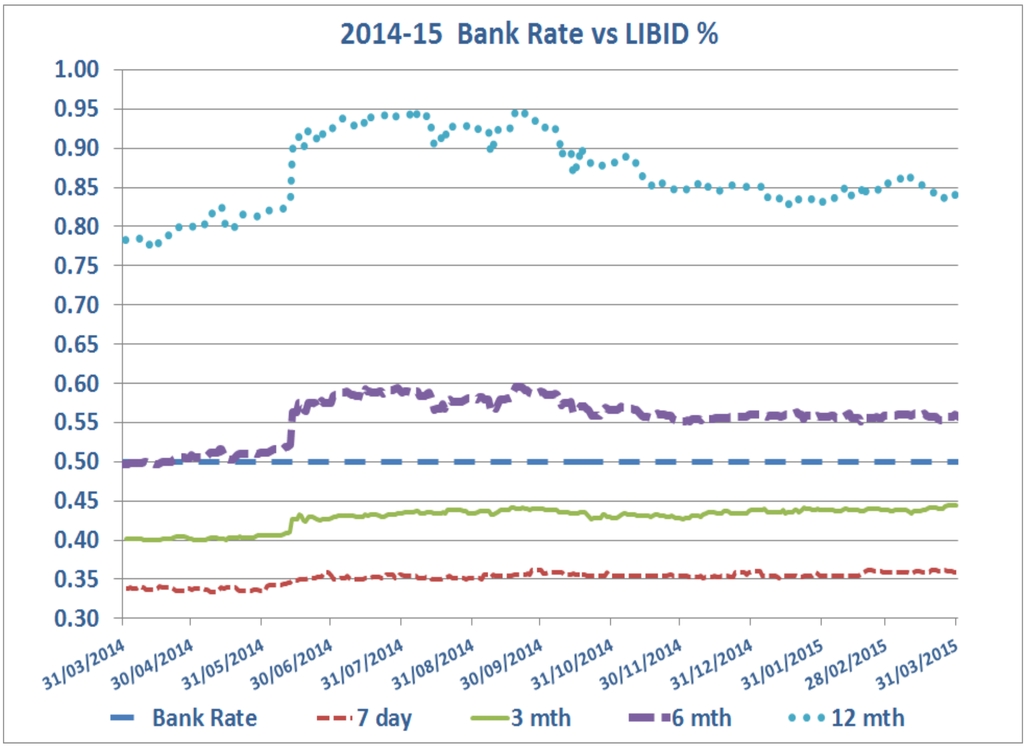

4.50%
4.00%
3.50%
3.00%
2.50%
2.00%
1.50%
1.00%
0.50%
31-Mar-14
30-Apr-14
31-May-14
30-Jun-14
31-Jul-14
31-Aug-14
30-Sep-14
31-Oct-14
30-Nov-14
31-Dec-14
31-Jan-15
28-Feb-15
31-Mar-15
50 Year Target
1 Year
5 Year
10 Year
50 Year

	1	1-1.5	2.5-3	3.5-4	4.5-5	9.5-10	24.5-25	49.5-50	1 month variable
1/4/14	1.240%	1.420%	1.990%	2.340%	2.650%	3.630%	4.290%	4.270%	1.250%
31/3/15	1.110%	1.190%	1.480%	1.680%	1.860%	2.450%	3.110%	3.080%	1.320%
High	1.490%	1.700%	2.280%	2.600%	2.870%	3.660%	4.300%	4.280%	1.340%
Low	1.080%	1.110%	1.380%	1.570%	1.710%	2.180%	2.850%	2.820%	1.250%
Average	1.266%	1.417%	1.863%	2.130%	2.362%	3.083%	3.737%	3.719%	1.290%
Spread	0.410%	0.590%	0.900%	1.030%	1.160%	1.480%	1.450%	1.460%	0.090%
High date	16/07/2014	03/07/2014	03/07/2014	03/07/2014	03/07/2014	20/06/2014	03/04/2014	02/04/2014	17/09/2014
Low date	23/01/2015	06/01/2015	07/01/2015	07/01/2015	02/02/2015	02/02/2015	02/02/2015	02/02/2015	01/04/2014

	1 Year	5 Year	10 Year	25 Year	50 Year
1/4/14	1.24%	2.65%	3.63%	4.29%	4.27%
31/3/15	1.11%	1.86%	2.45%	3.11%	3.08%
Low	1.08%	1.71%	2.18%	2.85%	2.82%
Date	23/01/2015	02/02/2015	02/02/2015	02/02/2015	02/02/2015
High	1.49%	2.87%	3.66%	4.30%	4.28%
Date	16/07/2014	03/07/2014	20/06/2014	03/04/2014	02/04/2014
Average	1.27%	2.36%	3.08%	3.74%	3.72%

8. Investment Rates in 2014/15 (Sector Treasury Management Advisors)

8.1 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.



9. Investment Outturn for 2014/15

9.1 **Investment Policy** – the Council's investment policy is governed by CLG guidance, which has been implemented in the annual investment strategy approved by Council on 03 March 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 and equity prices).

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

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

Balance Sheet Resources	31 March 2014 £'000	31 March 2015 £'000
Balances	2,160	4,160
Earmarked reserves	12,231	10,658
Provisions	462	379
Usable capital receipts	2,393	2,407
Total	**17,246**	**17,604**

9.3 **Investments held by the Council** – the Council maintained an average balance of £21.233m of internally managed funds (excluding Icelandic Bank deposits). The internally managed funds earned an average rate of return of 0.97%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.35%. This compares with a budget assumption of £0.2m investment balances earning an average rate of 1.00%.

10. Performance Measurement

10.1 One of the key requirements in the Code is the formal introduction of performance measurements 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.

10.2 The following performance indicator is measured

- **Investments – Internal returns above the 7 day LIBID rate**

10.3 Security and liquidity benchmarks are being developed and were introduced for 2014/15. These benchmarks were not exceeded at any point in the year.

- See Appendix A

11. Icelandic Investment (Escrow Account)

11.1 As previously reported in respect of Glitnir, the Council has received 100% of its claim in full settlement for Glitnir Bank hf. However, an element of the distribution (£0.202m, balance sheet 31 March 2014) was in Icelandic Kroner which had been placed in an escrow account in Iceland and was earning interest of 4.2%. This element of the distribution had been retained in Iceland due to currency controls operating in Iceland and as a result was subject to exchange rate risk, over which the Council had no control.

11.2 In February, the Council disposed of the investment held in our Escrow account which resulted in a receipt of £158k in the year.

APPENDIX A

Security Benchmarking 31 March 2015

Today's Date	31/03/2015	
	Prudential Indicators & Liquidity Limits	Credit Risk Maximum
Liquidity	£2,000,000	
1 year		0.00%
2 years		0.00%
3 years		0.00%
4 years		0.03%
5 years	£2,000,000	0.06%

Date (not needed for the analysis	Counterparty A	Principal B	Maturity Date C	(not needed for the credit analysis D	Country E	Sector Limits F	Current Long Term rating (Fitch or equivalent) G	Long Term Rating for Table H	Remaining Life in Years I	Life Per table Equivalent J	Historic Risk of default K	Weighting L = B*K*I/J
	Investment Position											
	Deutsche Bank - Sterling				UK	MMF	AAA	AAA	0.00	1	0.000%	**£0**
	Lloyds Bank	£500,000	14-Aug-15	1.010%	UK	Banks - UK	A	A	0.37	1	0.089%	**£166**
	Lloyds Bank	£1,000,000	17-Jun-15	0.950%	UK	Banks - UK	A	A	0.21	1	0.089%	**£190**
	Royal Bank of Scotland(95 day notice	£0			UK	Banks - UK	A	A		1		**£0**
	Lloyds TSB	£500,000	12-Oct-15	1.000%	UK	Banks - UK	A	A	0.53	1	0.089%	**£238**
	LGIM	£2,600,000	01-Apr-15		UK	MMF	AAA	AAA	0.00	1	0.000%	**£0**
	Birmingham City Council	£2,000,000	13-May-15	0.550%	UK	Local Authorities			0.12	1	#N/A	
	Lloyds Bank - Deposit Account				UK	Banks - UK	A	A	0.00	1	0.089%	**£0**
	Ignis - Liquidity Fund				UK	MMF	AAA	AAA	-115.25	1	0.000%	**£0**
	Insight - Liquidity Fund	£2,000,000	01-Apr-15		UK	MMF	AAA	AAA	0.00	1	0.000%	**£0**
	Lloyds TSB	£500,000	19-Jun-15	0.700%	UK	Banks - UK	A	A	0.22	1	0.089%	**£97**
	CCLA - LAPF	£2,000,000			UK							
	Nationwide	£1,000,000	15-Sep-15	0.980%	UK	Building Societies - Term	A-	A	0.46	1	0.089%	**£409**
	Goldman Sachs	£5,000,000	16-Sep-15	1.025%	UK	Banks - UK	A	A	0.46	1	0.089%	**£2,059**
	Insight - Liquidity Plus Fund	£1,000,000	07-Apr-15		UK	MMF	AAA	AAA	0.02	1	0.000%	**£0**
	Ignis - Short Duration Fund	£500,000	07-Apr-15		UK	MMF	AAA	AAA	0.02	1	0.000%	**£0**
	Total	**£18,600,000**				**LIQUIDITY - Weighted Average Life**			**0.05**	**RISK Factor:**	**0.017%**	**£3,159**
							Added by RG	WLDC Benchmarks	0.25		0.03%	

Risk Weighting per year	
Total weighting per £m	0.017%
Weighting for investment maturing < 1 year	0.029%
Weighting for investments maturing 1 to 2 years	0.000%
Weighting for investments maturing 2 to 3 years	0.000%
Weighting for investments maturing 3 to 4 years	0.000%
Weighting for investments maturing 4 to 5 years	0.000%