Council
5 September 2016

Subject: Annual Report on the Treasury Management Service and Actual Prudential and Treasury Indictors 2015/16

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 2015/16 and the actual Prudential Indicators for 2015/16.

RECOMMENDATION(S):

That Members accept the Annual Treasury Management Report for 2015/16 and approve the actual 2015/16 Prudential and Treasury Indicators contained therein.

IMPLICATIONS

Legal: None arising as a result of this report.

Financial: FIN/47/17: 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 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 meeting held 3 March 2015
- a Mid-Year (minimum) Treasury Update Report – Council meeting held 27 October 2015
- an Annual Treasury Management Report following the year describing the activity compared to the strategy (this report).

In addition, the Corporate Policy and Resources Committee has received quarterly Treasury Management update reports on 30 July 2015, 27 October 2015, 11 February 2016 and 12 May 2016.

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 2016 in order to support Members' scrutiny role.

Executive Summary

During 2015/16, 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	2014/15 Actual £'000	2015/16 Original £'000	2015/16 Revised £'000	2015/16 Actual £'000
Capital expenditure	1,711	9,689	4,144	962
Capital Financing Requirement:	1,631	6,260	1,429	1,403
Gross Borrowing (Finance Leases)	570	608	364	346
Gross Investments				
• Longer than 1 year	2,000	2,000	2,000	2,000
• Under 1 year	16,600	16,887	22,600	18,200
Total	**18,600**	**18,887**	**24,600**	**20,200**
Net borrowing/ (investments)	**(18,030)**	**(18,279)**	**(24,236)**	**(19,954)**

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 2015/16 continued with a challenging investment environment of previous years, namely low investment returns.

1. Introduction and Background

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; and
- Detailed investment activity

2. The Council's Capital Expenditure and Financing 2015/16

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	2014/15 Actual £'000	2015/16 Original £'000	2015/16 Revised Estimate £'000	2015/16 Actual £'000
Capital expenditure	**1,711**	**9,689**	**4,144**	**962**
Resourced by:				
Capital receipts	244	1,249	900	560
Capital grants / Contributions	362	743	680	356
Revenue	932	2,797	2,460	46
Leases	69	0	0	0
S106	104	0	104	0
Unfinanced capital expenditure	**0**	**4,900**	**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 2015/16 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 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.

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 need. 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 2015/16 MRP Policy (as required by CLG Guidance) was approved as part of the Treasury Management Strategy Report for 2015/16 on 3 March 2015.

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, which increase the Council's borrowing need. No borrowing is actually required against these schemes as the borrowing facility is included in the contract.

Capital Financing Requirement	**31 March 2015 Actual £'000**	**31 March 2016 Budget £'000**	**31 March 2016 Revised £'000**	**31 March 2016 Actual £'000**
Opening balance	**1,745**	**1,631**	**1,636**	**1,631**
Adj for previous year financing	0	0	0	0
Add adjustment for the inclusion of on-balance sheet leasing arrangements	69	0	0	4
Less Finance Lease repayments/MRP	(183)	(207)	(207)	(228)
Closing balance	**1,631**	**1,424**	**1,429**	**1,407**

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 (2015/16) plus the estimates of any additional capital financing requirement for the current year (2016/17) and the next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allowed the Council some flexibility to borrow in advance of its immediate capital needs in 2015/16. 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 2015 Actual £'000	31 March 2016 Original £'000	31 March 2016 Revised £'000	31 March 2016 Actual £'000
Gross borrowing position	**570**	**6080**	**364**	**346**
CFR	**1,631**	**6,260**	**1,429**	**1,407**

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 2015/16 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.

	2015/16 £'000
Authorised Limit	**12,500**
Maximum gross borrowing position	**346**
Operational Boundary	**608**
Average gross borrowing position	**0**
Financing costs as a proportion of net revenue stream	**1.27%**

4. Treasury Position as at 31 March 2016

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 2015/16 the Council's treasury position (excluding finance leases) was as follows:

Actual borrowing position	31 March 2015		31 March 2016	
	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	**1,631**		**1,403**	
Finance lease liabilities £'000	**570**		**346**	
Over/(under) borrowing £'000	**(1,517)**		**(1,065)**	
Bank and Money Market deposits	**31 March 2015**		**31 March 2015**	
	Principal £'000	**Average Rate**	**Principal £'000**	**Average Rate**
Fixed Interest money market and bank deposits	10,500	0.92%	13,500	0.94%
Variable Interest money market and bank deposits	8,100	1.49%	6,700	2.10%
Total Investments/Cash Equivalents	**18,600**	**2.41%**	**20,200**	**3.04%**
Net borrowing position	**(18,030)**		**(19,854)**	

The maturity of the investment portfolio was as follows:

	31 March 2015 Actual £'000	**2015/16 Original limits £'000**	**31 March 2016 Actual £'000**
Investments/Cash Equivalents			
Longer than 1 year	2,000	2,000	2,000
Under 1 year	16,600	14,887	18,200
Total	**18,600**	**16,887**	**20,200**

Note: Excludes bank current account balance.

5. The Strategy for 2015/16

5.1 The expectation for interest rates within the treasury management strategy for 2015/16 anticipated 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 actual movement in gilt yields meant that the general trend in PWLB rates during 2015/16 was an increase in rates during the first quarter followed by marked bouts of sharp volatility since July 2015 but with an overall dominant trend for rates to fall to historically low levels by the end of the year.

6. The Economy and Interest Rates

6.1 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 (GDP) in the UK surged strongly during both 2013/14 and 2014/15 to make the UK the top performing advanced economy in 2014. However, 2015 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 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 materially. These rates continued at very low levels during 2015/16.

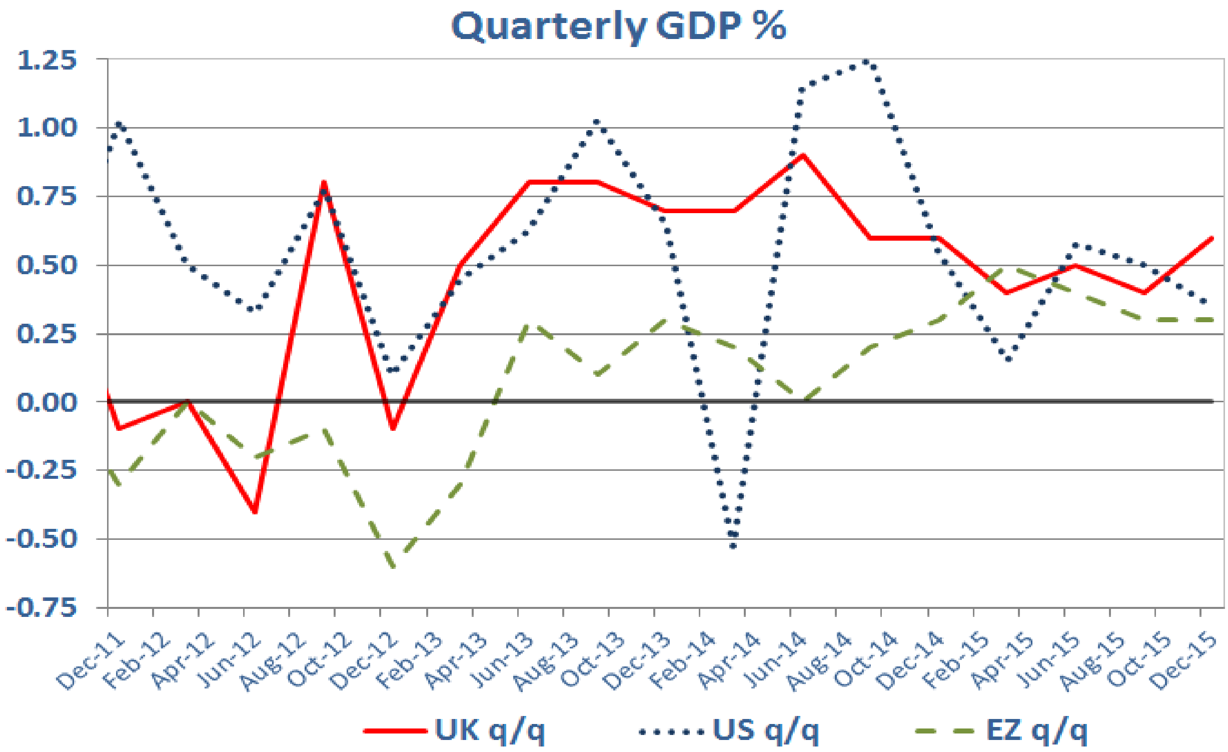
The sharp volatility in equity markets during the year was reflected in sharp volatility in bond yields. However, the overall dominant trend in bond yields since July 2015 has been for yields to fall to historically low levels as forecasts for inflation have repeatedly been revised downwards and expectations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

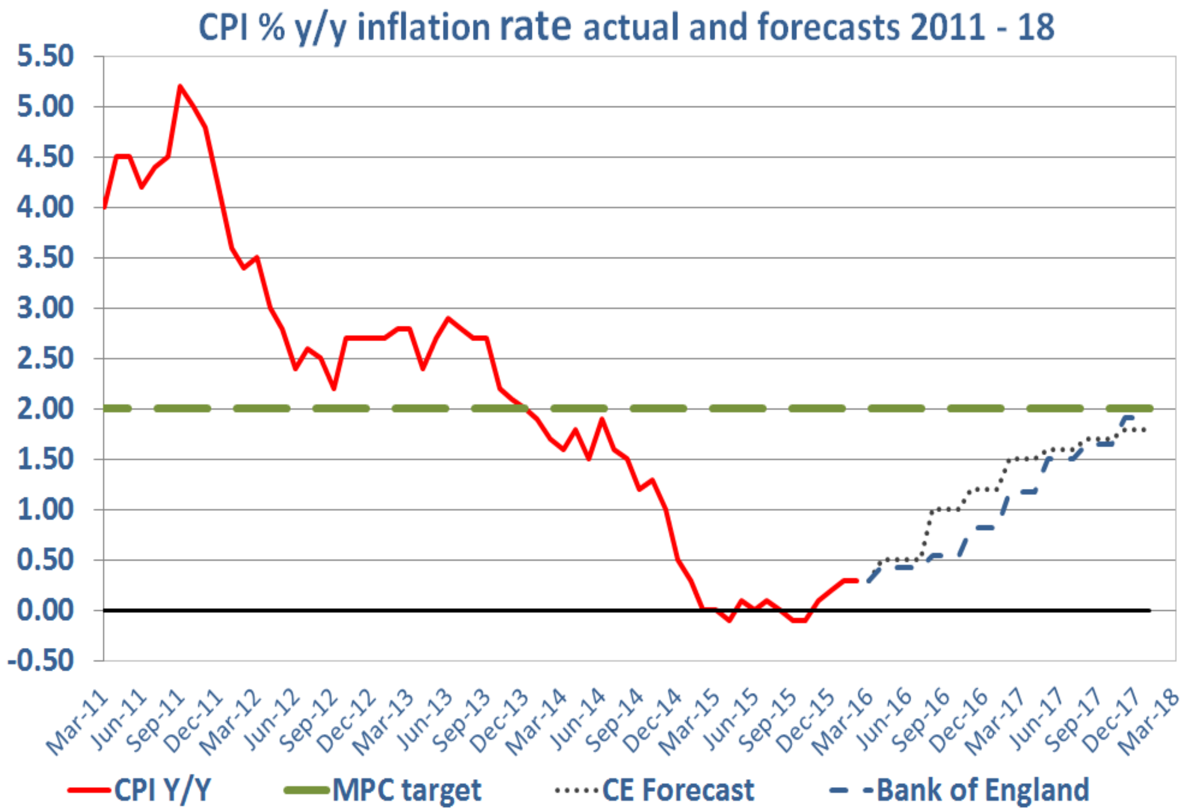
The ECB had announced in January 2015 that it would undertake a full blown quantitative easing programme of purchases of Eurozone government and other bonds starting in March at €60bn per month. This put downward pressure on Eurozone bond yields. There was a further increase in this programme of QE in December 2015. The anti-austerity government in Greece, elected in January 2015 eventually agreed to implement an acceptable programme of cuts to meet EU demands after causing major fears of a breakup of the Eurozone. Nevertheless, there are continuing concerns that a Greek exit has only been delayed.

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.

On the international scene, concerns have increased about the slowing of the Chinese economy and also its potential vulnerability to both the bursting of a property bubble and major exposure of its banking system to bad debts. The Japanese economy has also suffered disappointing growth in this financial year despite a huge programme of quantitative easing, while two of the major emerging market economies, Russia and Brazil, are in recession. The situations in Ukraine, and in the Middle East with ISIS, have also contributed to volatility.

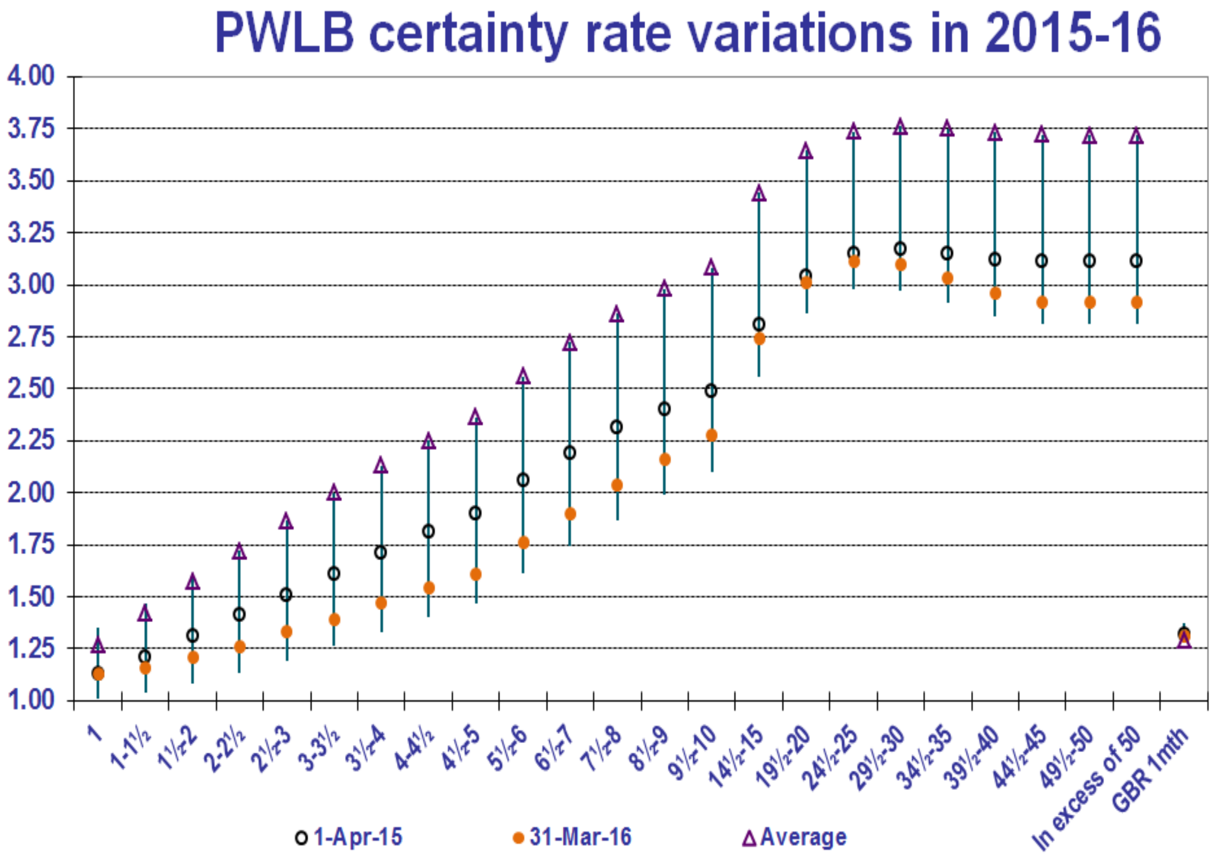
The UK elected a majority Conservative Government in May 2015, removing one potential concern but introducing another due to the promise of a referendum on the UK remaining part of the EU. The government maintained its tight fiscal policy stance but the more recent downturn in expectations for economic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

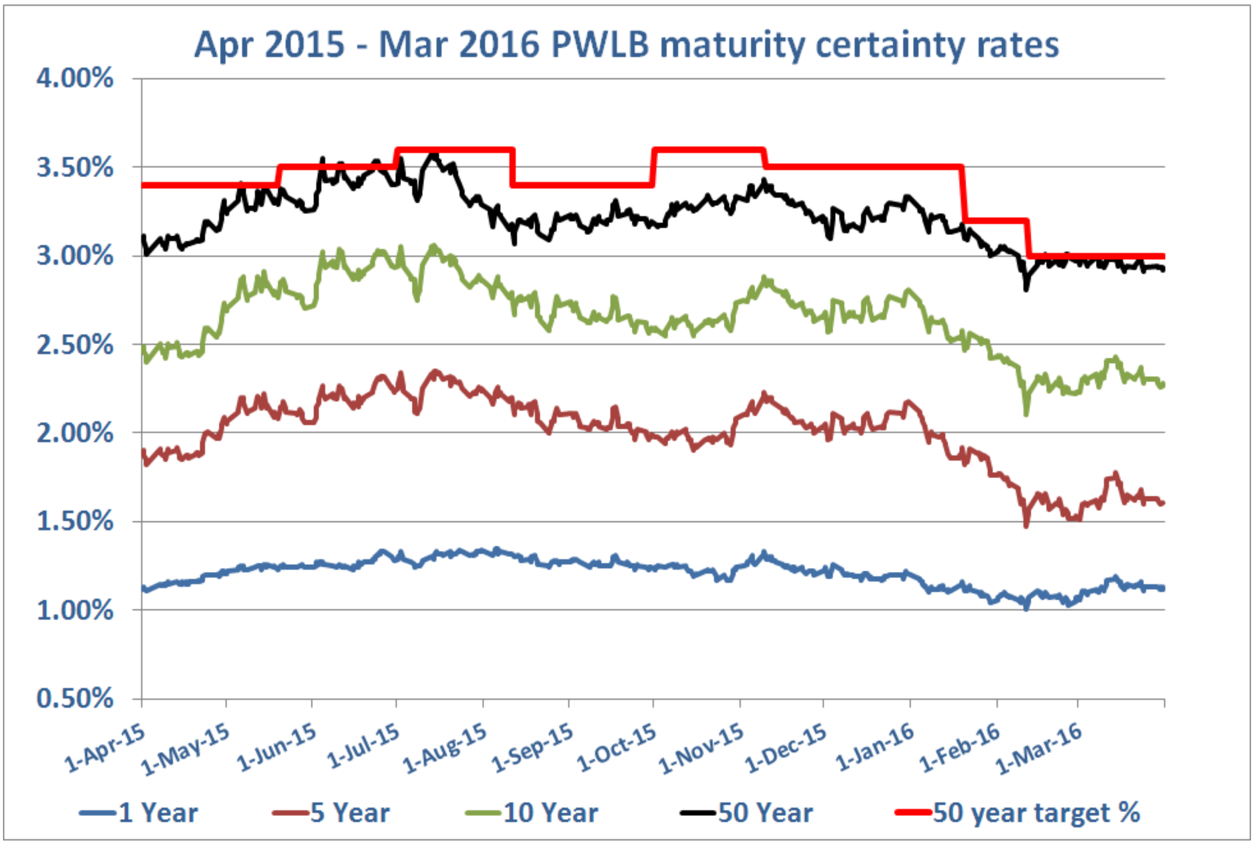




7. Borrowing Rates in 2015/16

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 2015-16
1-Apr-15
31-Mar-16
Average
GBR 1mth
In excess of 50

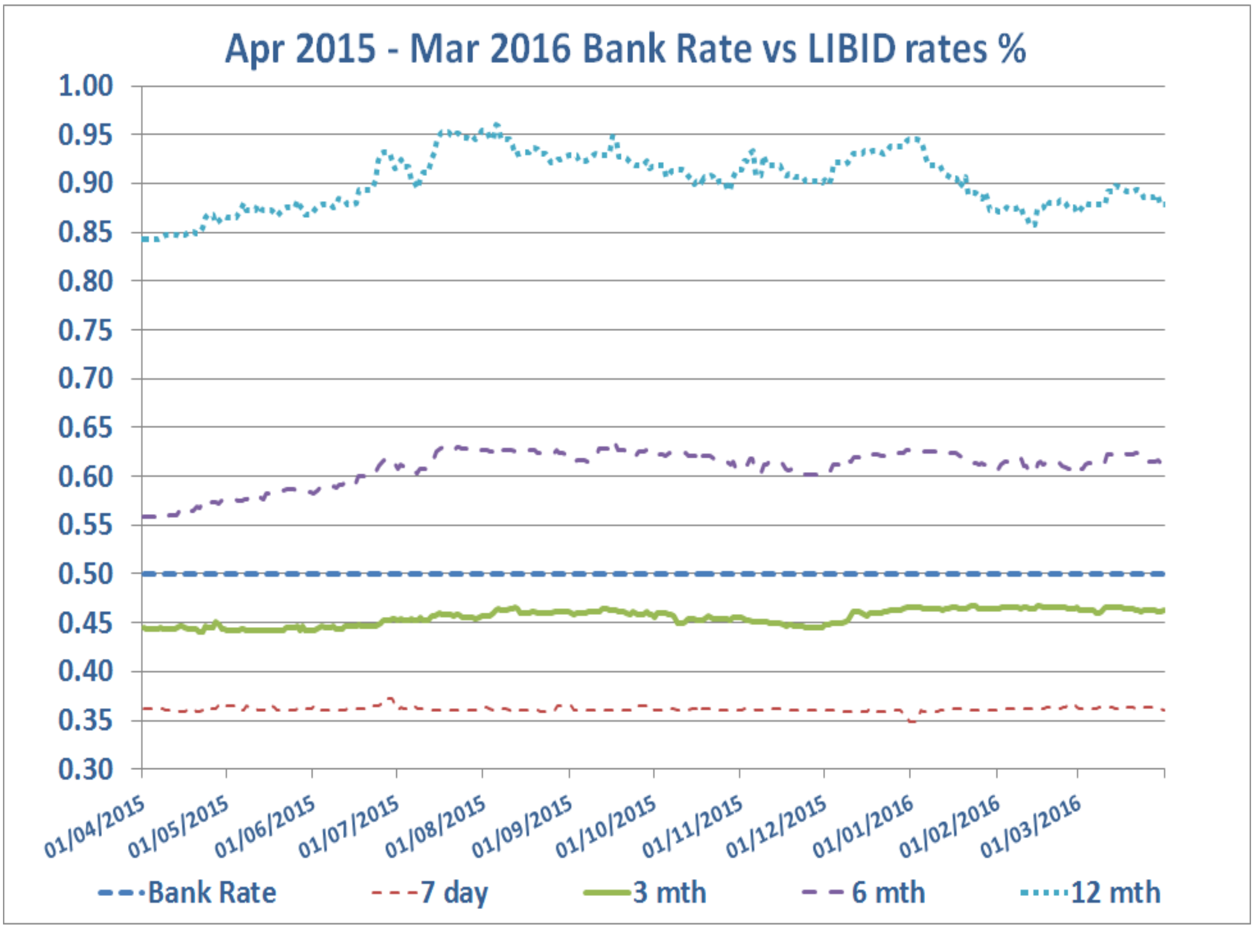

Apr 2015 - Mar 2016 PWLB maturity certainty rates
1 Year
5 Year
10 Year
50 Year
50 year target %

	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
1/4/15	1.130%	1.210%	1.510%	1.710%	1.900%	2.490%	3.150%	3.110%	1.320%
31/3/16	1.130%	1.160%	1.330%	1.470%	1.610%	2.280%	3.110%	2.920%	1.310%
High	1.350%	1.470%	1.860%	2.120%	2.350%	3.060%	3.660%	3.580%	1.370%
Low	1.010%	1.040%	1.190%	1.330%	1.470%	2.100%	2.980%	2.810%	1.310%
Average	1.212%	1.302%	1.608%	1.814%	2.004%	2.653%	3.348%	3.216%	1.336%
Spread	0.340%	0.430%	0.670%	0.790%	0.880%	0.960%	0.680%	0.770%	0.060%
High date	05/08/2015	06/08/2015	02/07/2015	15/07/2015	14/07/2015	14/07/2015	02/07/2015	14/07/2015	30/10/2015
Low date	11/02/2016	11/02/2016	11/02/2016	11/02/2016	11/02/2016	11/02/2016	11/02/2016	11/02/2016	21/03/2016

	1 Year	5 Year	10 Year	25 Year	50 Year
1/4/15	1.13%	1.90%	2.49%	3.15%	3.11%
31/3/16	1.13%	1.61%	2.28%	3.11%	2.92%
Low	1.01%	1.47%	2.10%	2.98%	2.81%
Date	11/02/2016	11/02/2016	11/02/2016	11/02/2016	11/02/2016
High	1.35%	2.35%	3.06%	3.66%	3.58%
Date	05/08/2015	14/07/2015	14/07/2015	02/07/2015	14/07/2015
Average	1.21%	2.00%	2.65%	3.35%	3.22%

8. Investment Rates in 2015/16

8.1 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.



9. Investment Outturn for 2015/16

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 3 March 2015. 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 2015 £'000	31 March 2016 £'000
Balances	4,160	3,715
Earmarked reserves	10,658	13,847
Provisions	379	1,012
Usable capital receipts	2,407	2,984
Total	**17,604**	**21,558**

9.3 **Investments held by the Council** – the Council held £20.2m of investments as at 31st March 2016 (£24.8m Qtr. 3, £24.6m Qtr.2 and £23.7m Qtr. 1) and the investment portfolio yield for the period was 1.19% (1.08% Qtr. 3, 1.09% Qtr. 2 and 1.14% Qtr. 1), the improvement reflects the investment in the Local Authority Property Fund.

The annualised weighted average rate of interest for Q4 was 1.13% and the comparable performance indicator is the average 7-day LIBID rate, which was 0.36%. 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 2015/16. See below:

Security Benchmarking (Supplementary Per Capital Watch 4 August 2009)

Today's Date	31/03/2016	PUT THIS TO TODAY'S DATE
	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	£1,000,000	19-Aug-16	0.750%	UK	Banks - UK	A+	A	0.39	1	0.089%	**£344**
	Royal Bank of Scotland(95 day notice)				UK	Banks - UK	BBB+	BBB	0.00	1	0.212%	**£0**
	Santander - 180 day notice account	£1,000,000	26-Sep-16	1.150%	UK	Banks - UK	A	A	0.49	1	0.089%	**£436**
	LGIM				UK	MMF	AAA	AAA	0.00	1	0.000%	**£0**
	Nationwide	£2,000,000	21-Nov-16	0.840%	UK	Building Societies - Term	A	A	0.64	1	0.089%	**£1,145**
	Lloyds Bank	£500,000	12-Sep-16	1.000%	UK	Banks - UK	A+	A	0.45	1	0.089%	**£201**
	Lloyds Bank	£1,000,000	08-Feb-17	1.050%	UK	Banks - UK	A+	A	0.86	1	0.089%	**£765**
	Lloyds Bank - Deposit Account				UK	Banks - UK	A+	A	0.00	1	0.089%	**£0**
	Standard Life (Ignis) - Liquidity Fund				UK	MMF	AAA	AAA	0.00	1	0.000%	**£0**
	Insight - Liquidity Fund	£700,000	01-Apr-16		UK	MMF	AAA	AAA	0.00	1	0.000%	**£0**
	CCLA - LAPF	£2,000,000			UK	Property		CCC	0.00	1		
	Santander - 365 day notice account	£2,000,000	30-Mar-17	1.300%	UK	Banks - UK	A	A	1.00	1	0.089%	**£1,774**
	Santander - 120 day notice account	£2,000,000	28-Jul-16	1.050%	UK	Banks - UK	A	A	0.33	1	0.089%	**£580**
	Goldman Sachs	£2,000,000	15-Apr-16	0.725%	UK	Banks - UK	A	A	0.04	1	0.089%	**£73**
	Insight - Liquidity Plus Fund	£4,000,000	06-Apr-16		UK	MMF	AAA	AAA	0.02	1	0.000%	**£0**
	Ignis - Short Duration Fund				UK	MMF	AAA	AAA	0.00	1	0.000%	**£0**
	Lloyds Bank	£1,000,000	03-May-16	0.750%	UK	Banks - UK	A+	A	0.09	1	0.089%	**£80**
	Nationwide	£1,000,000	03-May-16	0.660%	UK	Building Societies - Term	A	A	0.09	1	0.089%	**£80**
	Total	**£20,200,000**				**LIQUIDITY - Weighted Average Life**			**0.31**	**RISK Factor:**	**0.027%**	**£5,479**
							Added by RG	WLDC Benchmarks	0.25		0.03%	

Risk Weighting per year	
Total weighting per £m	0.027%
Weighting for investment maturing < 1 year	0.027%
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%