

Agenda Item No:	11	
Committee:	Corporate Governance Committee	
Date:	14 July 2015	
Report Title:	Treasury Management Annual Report 2014/15	

Cover sheet:

1 Purpose / Summary

The purpose of this report is to consider the overall financial and operational performance of the Council's treasury management activity for 2014/15. This report has been considered by Cabinet on 18 June 2015 and will be presented to Council on 23 July 2015.

2 Key issues

- Outstanding loans and finance lease liabilities of £8,426,460 and temporary investments of £18,300,000 as at 31 March 2015.
- The average rate on the long term external debt portfolio was 6.02% at 31 March 2015.
- Due to the Council's long term PWLB debt portfolio (£4.5m at 31/03/15) currently attracting excessive premiums it was not financially advantageous for the Council to comply with the Gross borrowing and Capital Financing Prudential Indicator in 2014/15. This is consistent with the strategy approved by Council in February 2014.
- No new borrowing was undertaken and the authorised limit was not breached during 2014/15.
- The investment activity during the year conformed to the approved strategy and the Council had no liquidity difficulties.
- Amount received from external investments £173,144.
- Overall interest rate achieved from investments 0.77% (7 day LIBID un compounded rate for 2014/15 0.35%).
- The upper limit for interest rate exposure was exceeded in 2014/15 due to higher cash balances (at year end) and due to the fact that no new borrowing or debt rescheduling was undertaken in 2014/15. This has not impacted on the Council's finances due to the short term nature of the Council's investment policy and limited opportunities to redeem long term debt.

3 Recommendations

- It is recommended that members note the report.

Wards Affected	All
Portfolio Holder(s)	Cllr John Clark, Leader Cllr Chris Seaton, Portfolio Holder, Finance
Report Originator(s)	Rob Bridge, Corporate Director and Chief Finance Officer Mark Saunders, Chief Accountant
Contact Officer(s)	Rob Bridge, Corporate Director and Chief Finance Officer Mark Saunders, Chief Accountant
Background Paper(s)	Treasury Management and Annual Investment Strategy 2014/15

Report:

1 Introduction

- 1.1 The Council is required through regulations issued under the Local Government Act 2003 to produce an annual treasury report reviewing treasury management activities and the actual prudential and treasury indicators for 2014/15. This report meets the requirements of both the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).
- 1.2 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 27/02/2014);
 - a mid-year treasury update report (Council 18/12/2014);
 - an annual review following the end of the year, describing the activity compared to the strategy (this report).
- 1.3 The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members.
- 1.4 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 Corporate Governance Committee before they were reported to Council.

2 The Economy and Interest Rates

- 2.1 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.
- 2.2 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 2 of 2016.
- 2.3 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.

2.4 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 general election due in May 2015.

3 Overall Treasury Position as at 31 March 2015

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

	31 March 2015 Principal £000	Rate / Return	Average Life years	31 March 2014 Principal £000	Rate / Return	Average Life years
Fixed rate funding						
• PWLB	4,500	7.29%	15.40 yrs	4,500	7.29%	16.40 yrs
• LOBO	3,300	4.70%	38.96 yrs	3,300	4.70%	39.96 yrs
• Finance Leases	626	3.00%	3.22 yrs	320	4.67%	2.18 yrs
Total debt	8,426			8,120		
Investments	(18,300)	0.77%		(16,450)	1.08%	
Net debt /(Investments)	(9,874)			(8,330)		

4 The Strategy for 2014/15

4.1 The expectation for interest rates within the strategy for 2014/15 anticipated low but rising bank rate (starting in quarter 4 of 2015) with similar gradual rises in medium and longer term fixed interest 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 counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

5 The Borrowing Requirement

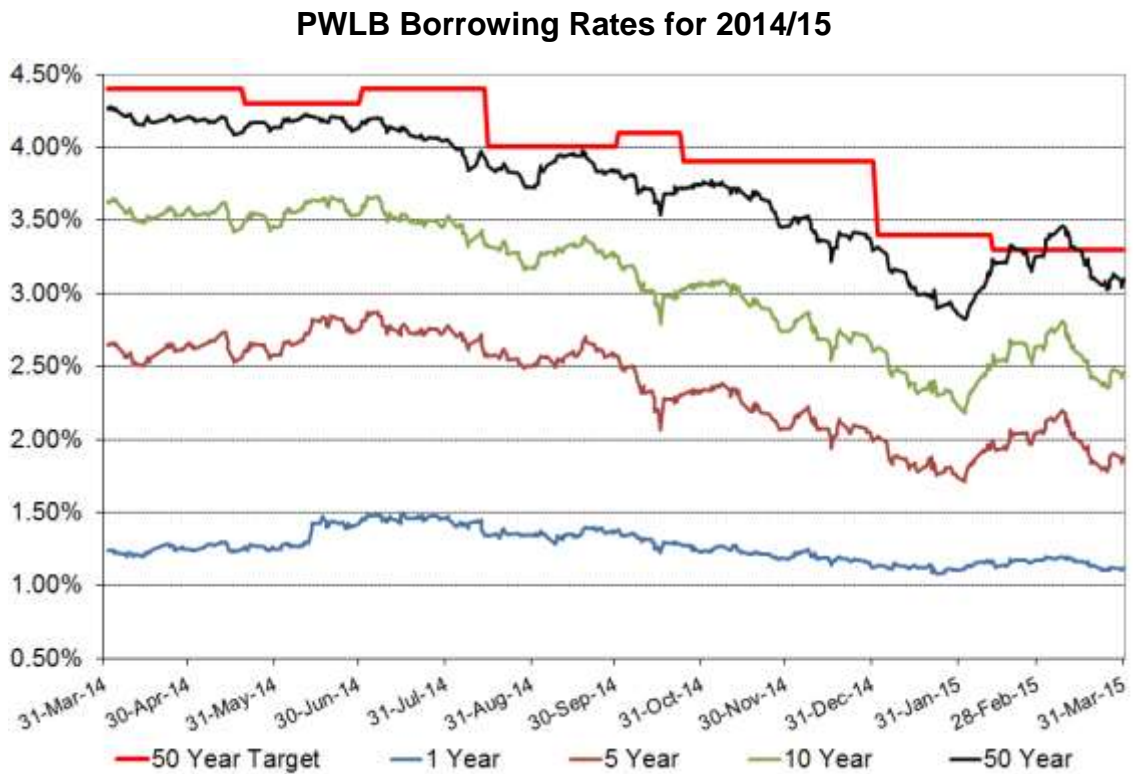
- 5.1 The Council's Capital Financing Requirement (CFR) for the year is shown below and represents a key prudential indicator.

	31 March 2014 Actual £000	31 March 2015 Estimate £000	31 March 2015 Actual £000
CFR opening balance	529	326	326
Capital expenditure on finance leases	0	480	477
Less finance lease repayments	(203)	(141)	(140)
CFR Closing balance	326	665	663

- 5.2 The CFR includes finance leases. A finance lease is a commercial arrangement between the Council and a lessor (finance company), where in consideration for a series of payments the Council has the right to use an asset (e.g. refuse vehicle, leisure equipment) for the lease duration (typically 3 to 7 years). The annual lease payment is made up of a capital and interest repayment.
- 5.3 Although legally the Council doesn't own the asset during the lease duration, International Accounting Standards require that the Council capitalise the asset and liability on its balance sheet, much like a loan.
- 5.4 One of the key prudential indicators is Gross borrowing and the CFR. This indicator is to ensure that borrowing levels are prudent over the medium term and only for a capital purpose. The Council should ensure that its gross debt, does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2014/15 and the following two financial years. This allows some flexibility for limited early borrowing for future years and ensures that long term borrowing is not undertaken for revenue purposes. Appendix A highlights the Council's borrowing position against the CFR.
- 5.5 As a result of the Council's long term PWLB debt portfolio (£4.5m at 31/03/15) currently attracting excessive premiums (£3.027m at the time of writing this report), if it were prematurely repaid, it is not financially advantageous for the Council to comply with this prudential indicator. This is consistent with the strategy approved by Council in February 2014.
- 5.6 The authorised limit is the "affordable borrowing limit" required by S3 of the Local Government Act 2003. 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 authorised limit was not breached during 2014/15.

6 Borrowing Outturn

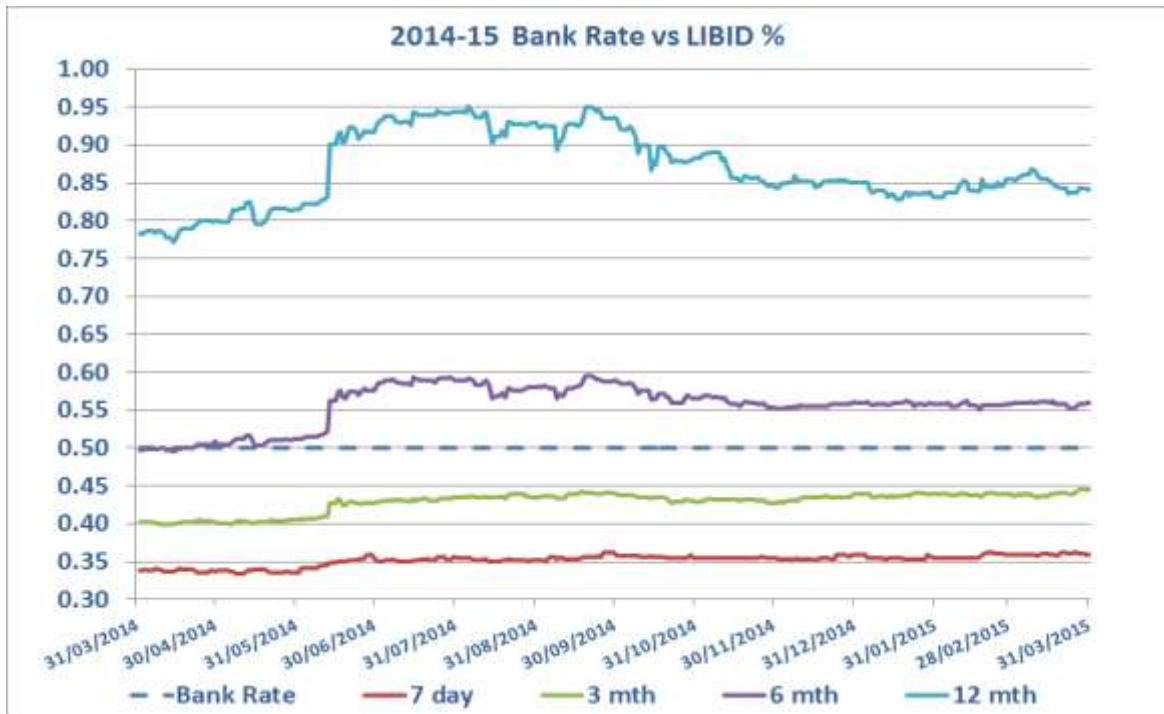
- 6.1 The graph below shows how PWLB certainty rates have fallen to historically very low levels during the year.



- 6.2 No long term or temporary borrowing was required. The approach during the year was to use cash balances to finance new capital expenditure, so as to run down cash balances that were earning low investment returns and to minimise counterparty risk incurred on investments.
- 6.3 No rescheduling was completed during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates and the penalty position which can arise from early repayment of debt, made rescheduling unviable.

7 Investment Outturn

- 7.1 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 moved back, from quarter 4 2015, to quarter 2 2016 by the end of the year. Deposit rates remained depressed during the whole year, primarily due to the effects of the Funding for Lending Scheme.



- 7.2 The Council's investment policy is governed by Communities and Local Government guidance, which has been implemented in the annual investment strategy approved by Council on 27 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 and bank share price). On 18 December 2014 the Council adopted a change to Capita Assets Services creditworthiness service, changing the credit methodology following the removal of implied Government support given to financial investments.
- 7.3 The investment activity during the year conformed to the approved strategy and the Council had no liquidity difficulties.
- 7.4 The Council maintained an average balance of £21.379m of internally managed funds. The internally managed funds earned an average rate of return of 0.77% (£173,144). The comparable performance indicator is the average 7-day LIBID rate, which was 0.35%.

8 Prudential and Treasury Indicators

- 8.1 During 2014/15 the Council complied with its legislative and regulatory requirements with the exception of gross borrowing and the CFR (see paragraph 5.4 above) and the upper limit for interest rate exposure being exceeded.
- 8.2 The purpose of the interest rate indicator is to limit the Council's exposure to the effects of changes in interest rates on its investments and borrowing. Higher cash balances (at year end) and the fact that no new borrowing or debt rescheduling was undertaken in 2014/15 resulted in upper limits for interest rate exposures being exceeded. This has not impacted on the Council's finances due to the short term nature of the Council's investment policy and limited opportunity to redeem long term debt.

Appendix A - Prudential Indicators

Prudential Indicators	2013/14 Actual £000	2014/15 Estimate £000	2014/15 Actual £000
1 Capital Expenditure	1,653	3,683	3,411
2 Ratio of Financing Costs to Net Revenue Stream (external interest – investment income)	1.90%	2.40%	2.38%
3 Gross Borrowing and the Capital Financing Requirement			
Gross Debt	8,120	8,460	8,426
CFR	326	665	663
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Treasury Management Indicators	2013/14 Actual £000	2014/15 Estimate £000	2014/15 Actual £000
4 Authorised Limit for External Debt			
Borrowing	15,000	15,000	15,000
Other Long Term Liabilities	2,000	2,000	2,000
Total	17,000	17,000	17,000
5 Operational Boundary for External debt			
Borrowing	10,000	10,000	10,000
Other Long Term Liabilities	2,000	2,000	2,000
Total	12,000	12,000	12,000
6 Actual External debt (as at 31 March)			
Borrowing	7,800	7,800	7,800
Other Long Term Liabilities	320	660	626
Total	8,140	8,460	8,426
7 Interest Rate Exposures			
Upper Limit - Fixed Rates	(2,880)	(2,020)	(3,874)
Upper Limit - Variable Rates	(2,150)	(3,700)	(6,000)
8 Upper Limit for Total Principal Sums Invested for Periods Longer than 364 Days	2,000	5,000	4,000