Agenda Item (11)
Appendix 'A'

Annual Treasury Management Review 2015/16

Purpose

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 Council should receive the following reports:

- an annual Treasury Strategy in advance of the year - Council - 24th February 2015;
- a mid-year (minimum) treasury update report - Council - 23rd February 2016;
- 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 as the reports were reviewed by the Audit Committee before they were reported to the Council.

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 Budget £000	2015/16 Actual £000
Capital expenditure	1,399	8,461	4,030
Capital Financing Requirement	0	0	0
Gross borrowing	0	0	0
External debt	0	0	0
Investments • Longer than 1 year • Under 1 year • Total	 0 21,096 **21,096**	 0 23,000 **23,000**	 0 22,342 **22,342**

Other prudential and treasury indicators are attached at Appendix 1 of this report.

The financial year 2015/16 continued the challenging investment environment of previous years, namely low investment returns.

Introduction and Background

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 how the Council has borrowed in relation to this indebtedness, and the impact on investment balances;
- Summary of interest rate movements in the year;
- Detailed investment activity.

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

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 through borrowing.

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

£m	2014/15 Actual £'000	2015/16 Budget £'000	2015/16 Actual £'000
Capital expenditure			
Financed in year	1,399	8,461	4,030
Financed by:			
Capital Receipts	488	7,264	2,673
Capital grants and other contributions	661	617	894
Revenue	250	250	250
Earmarked Reserves	0	230	212
Total Financing	1,399	8,461	4,030
Unfinanced capital expenditure	**0**	**0**	**0**

2. The Council's Overall Borrowing Need

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

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.

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

The Council took no long term borrowing out during 2015/16 and remains debt free.

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 (2015/16) and 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 either borrow in advance of its immediate capital needs in 2015/16 or reduce its investments. The table below highlights the Council's gross borrowing position against the CFR:-

	31 March 2015 Actual	31 March 2016 Budget	31 March 2016 Actual
Gross borrowing position	0	0	0
CFR	0	0	0

The authorised limit - the authorised limit is the "affordable borrowing limit" required by s3 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.

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.

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
Authorised limit	£6.5m
Operational boundary	£4.5m
Average gross borrowing position	£0
Financing costs as a proportion of net revenue stream	-3.11%

3. Treasury Position as at 31 March 2016

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 through Member reporting detailed in the summary. At the beginning and the end of 2015/16, the Council's treasury position was as follows:-

	31 March 2015 Principal	Rate/Return	31 March 2016 Principal	Rate/Return
Total debt	£0	-	£0	-
CFR	£0	-	£0	-
Over / (under) borrowing	£0	-	£0	-
Investments:				
- in house	£21.096m	0.67%	£22.342m	0.76%

4. The Economy and Interest Rates

Market expectations for the first increase in Bank Rate moved considerably during 2015/16, starting at Quarter 3 of 2015 but soon moving back to Quarter 1 of 2016. However, by the end of the year, market expectations had moved back radically to Quarter 2 of 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 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 ECB 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.

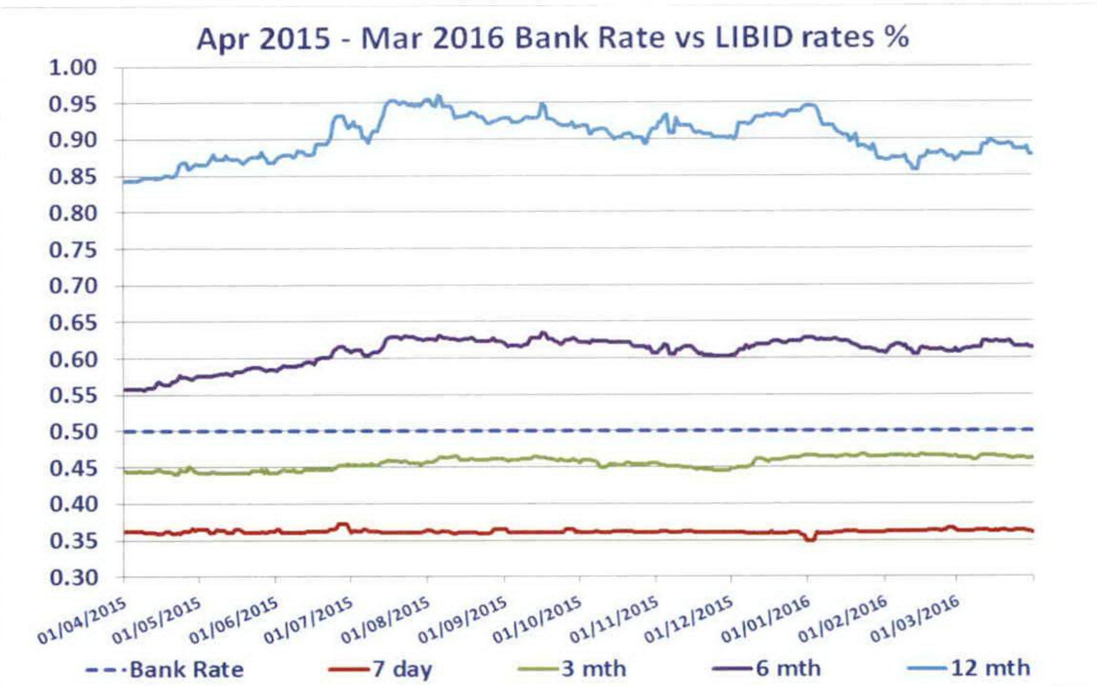
5. The Strategy for 2015/16

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). 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.

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.

6. 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 changed during the year and the current prediction is that there will be no movement in base rates until 2018. 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.



7. Investment Outturn for 2015/16

Investment Policy - the Council's investment policy is governed by CLG guidance, which was been implemented in the annual investment strategy approved by the Council on 24th February 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, bank share prices etc.).

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

The Council maintained an average balance of £29.311m of internally managed funds during the financial year. The internally managed funds earned an average rate of return of 0.76%. The comparable performance indicator is the average 3 month LIBID rate, which was 0.46%. This compares with a budget assumption of £24m investment balances earning an average rate of 0.70%, £170,750 investment interest for 2015/16 but made an actual return of £223,518, a surplus of £52,768. Interest accrued for 2015/16 from the Glitnir investment totalled £18,499. On top of this, the Council made a gain on the exchange rate on monies held in the Escrow Account of £69,643. In total, £88,142 has been made to the investment interest account. This surplus has been transferred to an earmarked reserve to offset any future exchange rate fluctuations.

Type of Investments	Balance on 01/04/2015 £	Average Weighed Balance Held 2015/16 £	Interest Earned in 2015/16 £	% Rate Achieved in 2015/16 %	Balance on 31/03/2016 £
Fixed Term Deposits	16,000,000	22,254,233	168,743	0.76	17,985,000
Call Accounts & MMF's	5,485,000	6,557,262	32,183	0.49	3,860,525
CCLA	0	500,000	22,591	4.52	496,204
Total Investments	**21,485,000**	**29,311,495**	**223,158**	**0.76**	**22,341,729**

In April 2015, the Council purchased £500k units in the CCLA Property Fund from the income of a sold asset. The plan is for the capital invested to grow over 5-7 years, whilst earning a higher return than what the council is currently achieving from the money market rates.

Appendix 1: Prudential and treasury indicators

1. PRUDENTIAL INDICATORS	2014/15	2015/16	2015/16
	actual	budget	actual
	£'000	£'000	£'000
Capital Expenditure	1,399	8,461	4,030
Ratio of financing costs to net revenue stream	-2.46%	-2.10%	-3.11%
CFR	0	0	0
Incremental impact of capital investment decisions - increase in council tax (band D) per annum [based upon investment interest foregone]	£0.08	£0.49	£0.34
2. TREASURY MANAGEMENT INDICATORS	2014/15	2015/16	2015/16
	Approved	Approved	Approved
	£'000	£'000	£'000
Authorised Limit for external debt	6,500	6,500	6,500
Operational Boundary for external debt	4,500	4,500	4,500
Actual external debt at 31st March	0	0	0

(END)