Annual Treasury Management Review 2014/15

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 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 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 (Audit and Scrutiny Committee 21/10/2014)
- 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 Audit Committee (and formerly the Audit and Scrutiny Committee) before they were reported to the full Council. Member training on treasury management issues was undertaken during the year on 21/10/2014 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 Actual £000
Capital expenditure	**2,879**	**6,990**	**1,399**
Capital Financing Requirement	**0**	**0**	**0**
Gross borrowing	**0**	**0**	**0**
External debt	**0**	**0**	**0**

Prudential and treasury indicators	2013/14 Actual £000	2014/15 Original £000	2014/15 Actual £000
Investments • Longer than 1 year • Under 1 year • Total	 0 23,600 **23,600**	No limit set	 0 21,052 **21,052**
Net Lending	**23,600**		**21,052**

Other prudential and treasury indicators are to be found in Appendix 1 of this report.

The financial year 2014/15 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 2014/15

The Council undertakes capital expenditure on long-term assets. During 2014/15, these activities were financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.). Therefore, the Council had no requirement to borrow to finance capital expenditure.

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	2013/14 Actual £000	2014/15 Estimate £000	2014/15 Actual £000
Capital expenditure			
Financed in year	2,879	6,990	1,399
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 2014/15 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 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 2014/15 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.

	2014/15
Authorised limit	£6.500m
Operational boundary	£4.500m
Average gross borrowing position	£0m
Financing costs as a proportion of net revenue stream	0%

3. 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 2014, 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 2014 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 2014, 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 go 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.

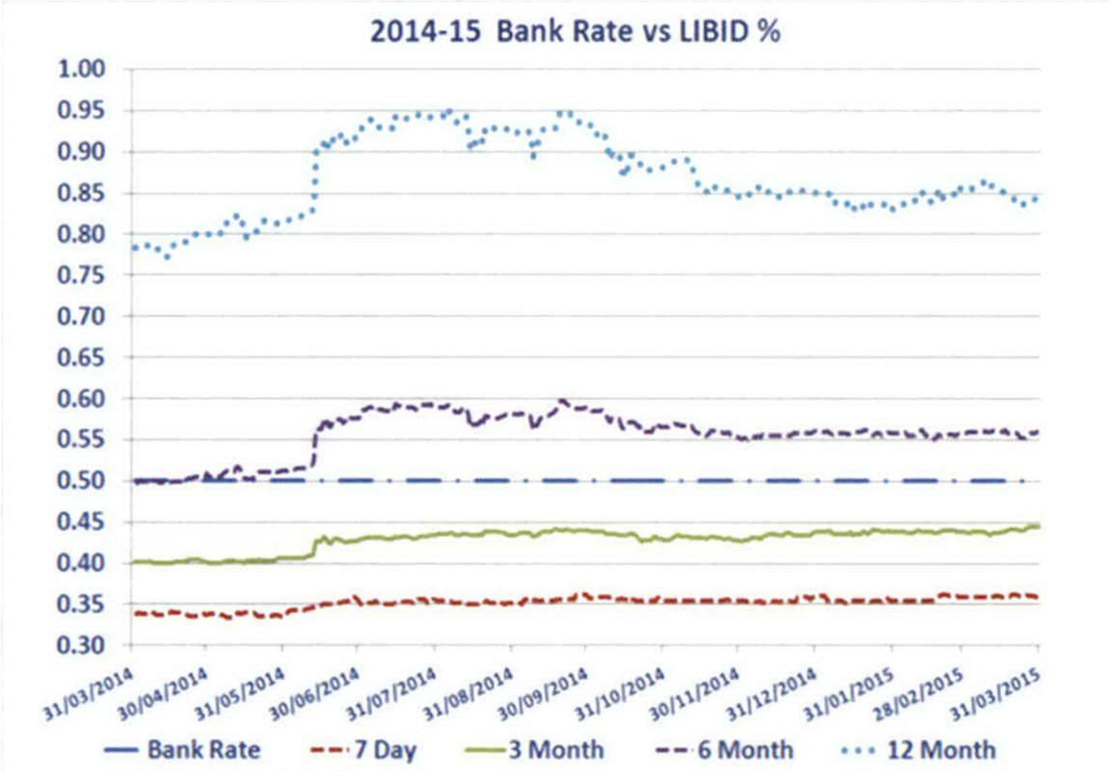
Gilt yields were on a falling trend for much of the last eight months of 2014/15 but were then pulled in different directions by increasing fears after the anti-austerity parties won power in Greece in January 2015; developments since then have increased fears that Greece could be heading for an exit 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 (EZ) 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 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.

4.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.

5. 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.



6. Investment Outturn for 2014/15

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 27th 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, bank share prices etc.).

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

Type of Investments	Principal Balance on 01/04/2014 £	Average Weighed Balance Held in 2014/15 £	Interest Earned in 2014/15 £	% Rate Achieved in 2014/15 %	Principal Balance on 31/03/2015 £
Fixed Term Deposits	10,000,000	15,772,603	126,294	0.80	11,500,000
Call Accounts & MMF's	6,638,784	9,477,076	37,362	0.39	9,105,046
Glitnir Escrow	466,181	466,181	16,386	3.51	446,701*
Total Investments	**17,104,965**	**25,715,860**	**180,042**	**0.70**	**21,051,747****

* The Glitnir Escrow investment balance was reduced due to exchange rate movement of £35,866 at the year end point of valuation
**The year end Balance within the Council's accounts shows a figure of £21,166,631. This difference reflects accrued interest of £70,188 and the Payden / Federated Funds adjustment of £44,696.

The Council maintained an average balance of £25.716m of internally managed funds during 2014/15. The internally managed funds earned an average rate of return of 0.7%. The comparable performance indicator is the average 3 month LIBID rate which was 0.43%.

The Council budgeted for £170,750 investment interest for 2014/15 but made an actual return of £180,043, a surplus of £9,293.

The Council also budgeted for interest from long-term loans and finance leases of £8,000. During the year, a long-term loan was redeemed and the Council received interest in lieu of the early redemption. This, together with other interest income from the Local Authority Mortgage Scheme and Ubico Ltd finance leases provided an additional surplus of £119,636. Overall interest receipts exceeded budget by £128,929.

The Council's investment in the Icelandic Bank Glitnir, although repaid in full, was not fully repatriated to this country as a proportion of the funds were paid in ISK currency and are held in an escrow account earning 4%. Until recently, there were currency restrictions in place which meant that this money could not be released back to the UK. The restrictions have recently been lifted; however, a tax will be applied to any currency repatriated to the UK. An adjustment of £30,728 has been made for exchange rate losses applicable to 2014/15. In July, the Cabinet will consider a recommendation that a further provision of £150,000 is made within the 2014/15 accounts to cover potential exchange rate losses, taxation or discounted costs to retrieve the funds at the earliest opportunity. Officers have used experience from recent currency auctions to determine a prudent level of provision for exchange losses.

A summary of the above detail is set out in the table below.

	2014/15 Budget	2014/15 Actual	2014/15 Variance
Treasury Activity	£170,750	£180,043	£9,293
Interest from loans and finance leases	£8,000	£127,636	£119,636
Actual exchange rate losses relating to 2014/15 (Glitnir balance)	£0	(£30,728)	(£30,728)
Overall variance on interest receipts	**£178,750**	**£276,951**	**£98,201**
Recommendation to Cabinet to increase provision for Glitnir exchange rate losses	£0	£150,000	£150,000

	2014/15 Budget	2014/15 Actual	2014/15 Variance
Overall interest position to be reported in statement of accounts	**£178,750**	**£126,951**	**(£51,799)**

Appendix 1: Prudential and treasury indicators

1. PRUDENTIAL INDICATORS	2013/14	2014/15	2014/15
Extract from budget report	actual	original	actual
	£'000	£'000	£'000
Capital Expenditure	2,879	6,990	1,399
TOTAL	2,879	6,990	1,399
Ratio of financing costs to net revenue stream General	-2.52%	-1.94%	-2.46%
Net borrowing requirement			
brought forward 1 April	£0	£0	£0
carried forward 31 March	£0	£0	£0
in year borrowing requirement	£0	£0	£0
Net debt	£'000	£'000	£'000
CFR	0	0	0
	0	0	0
Incremental impact of capital investment decisions	£	£	£
Increase in council tax (band D) per annum *	0.34	0.88	0.08

2. TREASURY MANAGEMENT INDICATORS	2013/14	2014/15	2014/15
	actual	original	actual
	£'000	£'000	£'000
Authorised Limit for external debt -			
borrowing	6.500	6,500	6,500
other long term liabilities	0	0	0
TOTAL	6,500	6,500	6,500
Operational Boundary for external debt -			
borrowing	4,500	4,500	4,500
other long term liabilities	0	0	0
TOTAL	4,500	4,500	4,500
Actual external debt	0	0	0