AGENDA ITEM 6

Policy Committee – 19 July 2016

Treasury Management Outturn Report 2015/16

Report of the Strategic Manager – Financial Services (s151 officer)

Lead Member – Financial Resilience: Councillor Mulligan

Ward(s) affected: All

1. Purpose of Report

To inform Members of the treasury activity undertaken in the year in the context of current and forecast economic climates.

2. Recommendations

Members are recommended to:

- Note the actual Treasury Management Indicators for 2015/16;
- Note the Treasury Management Annual Report for 2015/16

3. Introduction

3.1 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 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).

3.2 During 2015/16 the reporting requirements were that the full Council or delegated committee should receive the following reports:

- an annual treasury strategy in advance of the year (Council 24/02/2015);
- a mid-year treasury update report (Policy Committee 03/11/2015);
- an annual review following the end of the year describing the activity compared to the strategy (this report).

3.3 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.

3.4 This 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 Policy Committee before they were reported to the full Council.

4. The Council's Capital Expenditure and Financing

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.

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

Table 1

	2014/15 Actual £000	2015/16 Estimate £000	2015/16 Actual £000
Capital expenditure	1,731	1,329	1,330
Financed in year	1,428	1,029	1,055
Unfinanced capital expenditure	303	300	275

5. Borrowing and the Capital Financing Requirement

5.1 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 activity 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.

5.2 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 the 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.

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).

5.3 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 24/02/2015.

5.4 The Council's CFR for the year is shown below, and represents a key prudential indicator.

Table 2

CFR	31 March 2015 Actual £000	31 March 2016 Budget £000	31 March 2016 Actual £000
Opening balance	5,548	6,001	5,533
Add unfinanced capital expenditure (as above)	303	300	275
Less MRP	(318)	(351)	(318)
Closing balance	5,533	5,950	5,490

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

5.5 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. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allowed the Council some flexibility for borrowing 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.

Table 3

	31 March 2016 Actual £000	31 March 2017 Forecast £000	31 March 2018 Forecast £000
Gross borrowing position	5,988	5,988	5,988
CFR	5,490	5,770	5,997

(The gross borrowing position for 2015/16 is slightly above CFR but only in the short term.)

5.6 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.

5.7 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.

5.8 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.

Table 4

	2015/16 £000
Authorised limit	9,750
Maximum gross borrowing position	5,988
Operational boundary	7,500
Average gross borrowing position	5,988
Financing costs as a proportion of net revenue stream 2015/16 *	5.63%
Financing costs as a proportion of net revenue stream 2014/15	5.63%

**(Net revenue stream is the total of taxation and non-specific grant income)*

6. Treasury Position as at 31 March 2016

6.1 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 as detailed in the summary, and through officer activity detailed in the Council's Treasury Management Practices. At the end of 2015/16 the Council's treasury position was as follows:

Table 5

	31 March 2015 Principal £000	Average Rate	Average Life	31 March 2016 Principal £000	Average Rate	Average Life
Total debt	5,988	4.27%	28.4yrs	5,988	4.27%	28.4yrs
CFR	5,533			5,532		
Over/(under) borrowing	0.455			0.456		
Investments	8,956	0.49%	130days	11,707	0.59%	183days

6.2 The maturity structure of the debt portfolio was as follows:

Table 6

	31 March 2015 actual	2015/16 original limits	31 March 2016 actual
Under 12 months	0	600	0
12 months and within 24 months	0	900	0
24 months and within 5 years	0	900	0
5 years and within 10 years	1,000	1,200	1,000
10 years and within 25 years	700	2,400	700
25 years and over	4,288	5,390	4,288

All investments were for less than one year.

7. The Strategy for 2015/16

7.1 The expectation for interest rates within the strategy for 2015/16 anticipated low but rising Bank Rate (starting in quarter 2 of 2015), and gradual rises in medium and longer term fixed borrowing rates during 2015/16. 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.

7.2 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.

7.3 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.

8. The Economy & Interest Rates

8.1 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.

8.2 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.

8.3 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.

8.4 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.

8.5 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.

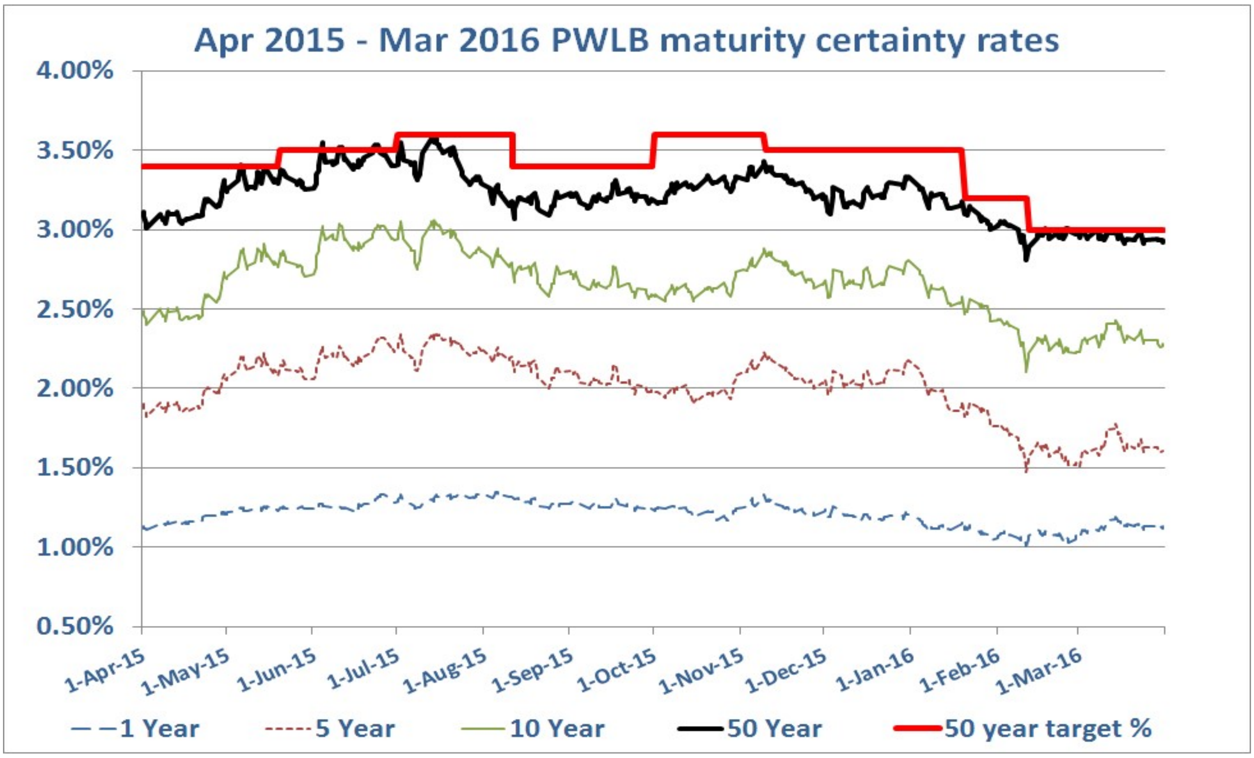
8.6 The UK elected a majority Conservative Government in May 2015, removing one potential concern but introducing another due to the promise of a referendum on the UK remaining part of the EU. The government maintained its tight fiscal policy stance but the more recent downturn in expectations for economic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

9. Borrowing Rates in 2015/16

PWLB maturity certainty borrowing rates - The graph below shows, 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 end of the financial year:

Table 7

	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%



10. Borrowing Outturn for 2015/16

Due to investment concerns, both counterparty risk and low investment returns, no borrowing was undertaken during the year.

The following table shows the Councils current borrowing:

<u>Table 8</u>

Lender	Date of Borrowing	Date of Maturity	Value	Interest Rate	Interest Paid
PWLB	04/11/2013	04/05/2021	500,000	2.89%	14,450
PWLB	04/11/2013	04/05/2023	500,000	3.28%	16,400
PWLB	01/12/2005	01/02/2031	700,000	4.25%	29,750
PWLB	17/09/2007	01/08/2057	2,000,000	4.55%	91,000
PWLB	17/09/2007	01/08/2057	2,288,110	4.55%	104,109

11. Investment Rates in 2015/16.

Bank Rate remained at its historic low of 0.50% 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.

12. Investment Outturn for 2015/16

12.1 Investment Policy – the Council's investment policy is governed by CLG guidance, which has 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, asset holdings, etc.).

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

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

Table 9

Balance Sheet Resources (£000)	31 March 2015 £000	31 March 2016 £000
Balances	712	677
Earmarked reserves	5,615	5,786
Provisions	318	318
Usable capital receipts	2,593	2,950
Total	**9,238**	**9,755**

12.3 Investments held by the Council - the Council maintained an average balance of £12.84m of internally managed funds. The internally managed funds earned an average rate of return of 0.71%. This compares with a budget assumption of £5.82m investment balances earning an average rate of 0.54%. A full list of investments is at Appendix A.

12.4 Additionally, the Council's investment income was boosted by a discount of £14,000 on the annual pensions contribution as a result of making a payment in advance. The total of investment income received from all sources is therefore £105,050.

13. Prudential and treasury indicators

The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

Table 10

Prudential Indicators	2014/15 Actual £000	2015/16 Original £000	2015/16 Actual £000
Capital expenditure	1,731	1,328	1,330
Capital Financing Requirement	5,533	5,950	5,490
Gross borrowing in year	0	0	0
Total external debt	5,988	5,988	5,988
Total investments	8,956	8,956	11,707
Net investments	2,968	2,962	5,719

Table 11

Treasury Management Indicators	2014/15 Actual £000	2015/16 Original £000	2015/16 Actual £000
Authorised Limit for external debt - borrowing	8,250	8,250	9,750
Operational Boundary for external debt	6,000	6,000	7,500
Actual external debt	5,988	5,988	5,988
Upper limit for fixed interest rate exposure expressed as net principal re fixed rate borrowing/investments	6,000	6,000	7,500
Upper limit for variable rate exposure expressed as net principal re variable rate borrowing/investments	0	0	0
Upper limit for total principal sums invested for over 364 days	0	0	0

14. Implications

14.1 Financial Implications - There are no financial implications associated with this report.

14.2 Legal Implications - There are no legal implications attached to this report.

15. Contribution to Corporate Priorities

The Treasury Management function does not contribute directly to the Council's Corporate Priorities albeit the delivery of the Treasury Management Strategy supports the Council's budget strategy which in turn is a fundamental element of the Council's service and financial planning approach to achievement of the Council Plan.

16. Risk Management

There are no direct risk management implications arising from this report. Regular review provides assurance that treasury management activities are being managed in line with the Treasury Management Strategy.

17. Equalities Impact Assessment

Since this report is not seeking to set or amend policy, the Council's Equality Impact Assessment procedure has not been followed.

18. Consultations with Others

None

19. <u>Access to Information : Background Documents</u>

Working papers held in Financial Services**.**

20. <u>Author of the Report</u>

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Note: Members are invited to contact the author in advance of the meeting with any detailed queries or questions.

Appendix A

Counterparty	Date of Investment	Date of Maturity	Value	Interest Rate	Interest Due or Forecast
Fixed term:					
Furness BS	01/10/2015	01/04/2016	1,000,000	0.68%	20
Progressive BS	01/10/2015	01/04/2016	500,000	0.70%	10
Newcastle BS	01/10/2015	01/04/2016	500,000	0.72%	10
Newcastle BS	15/02/2016	13/02/2017	500,000	1.15%	5,010
National Counties BS	05/10/2015	05/04/2016	1,000,000	0.70%	80
Bank of Scotland	16/07/2015	15/04/2016	1,000,000	0.80%	310
Skipton BS	02/03/2016	02/09/2016	1,000,000	0.70%	2,950
Barclays Bank	02/03/2016	02/09/2016	1,000,000	0.65%	2,740
Manchester BS	07/03/2016	07/09/2016	1,000,000	0.75%	3,270
West Bromwich BS	31/03/2016	30/09/2016	1,000,000	0.72%	3,610
Nottingham BS	15/02/2016	13/02/2017	500,000	1.01%	4,400
Commonwealth Bank of Australia	03/02/2016	01/02/2017	1,000,000	0.78%	6,540
Notice Accounts:					
Santander 95-day	07/10/2015	On notice	1,000,000	0.90%	9,000
Money Market Funds:					
Insight	n/a	n/a	700,000	0.48%	n/a
TOTAL INVESTMENTS			**11,700,000**		

Transaction Accounts:					
Lloyds Bank Current Account	n/a	n/a	271,670	0.40%	n/a
Bank of Scotland	n/a	n/a	7,070	0.40%	n/a