ITEM NO. 11.1

Report of:	**Head of Finance**
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Report Track:	**Audit & Governance: 23/06/15; & Council: 08/07/15**

COUNCIL

8 JULY, 2015

ANNUAL TREASURY MANAGEMENT REPORT 2014/15

1 Purpose of Report

1.1 To update members on treasury management activity and performance during the 2014/15 financial year.

2 Recommendations

2.1 To approve the actual 2014/15 prudential and treasury indicators set out in the **APPENDIX.**

2.2 To note the annual treasury management report for 2014/15.

3 Key Issues and Reasons for Recommendation

3.1 Treasury management activity and performance during the 2014/15 financial year.

4 Relationship to Corporate Priorities

4.1 Treasury management and investment activity link in with all of the Council's priorities and their spending plans.

5 Report Detail

5.1 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 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).

5.2 During 2014/15 the minimum reporting requirements were that the full Council should receive the following reports:-

- an annual treasury strategy in advance of the year (Council 12 February 2014);
- a mid year treasury update report Audit & Governance 18 November 2014);
- an annual review following the end of the year describing the activity compared to the strategy (this report).

5.3 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.

5.4 The Council has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Audit and Governance Committee before they were reported to the full Council.

5.5 This report summarises:-

- Capital activity during the year;
- Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement);
- Reporting of the required 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 debt activity; and
- Detailed investment activity.

The Economy and Interest Rates

5.6 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. 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 3 of 2016.

5.7 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. 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.

Overall Treasury Position as at 31 March 2015

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

TABLE 1	31 March 2014 Principal	Rate/ Return	Average Life yrs	31 March 2015 Principal	Rate/ Return	Average Life yrs
Total debt (PWLB)	£88.8m	4.05%	26.0	£85.9m	4.14%	28.1
CFR	£97.7m	-	-	£97.1m	-	-
Over / (under) borrowing	(£8.9m)	-	-	(£11.2m)	-	-
Total investments	£10.3m	0.49%	0.37	£11.7m	0.75%	0.57
Net debt	£78.5m	-	-	£74.2m	-	-

Strategy for 2014/15

5.9 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.

5.10 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.

5.11 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.

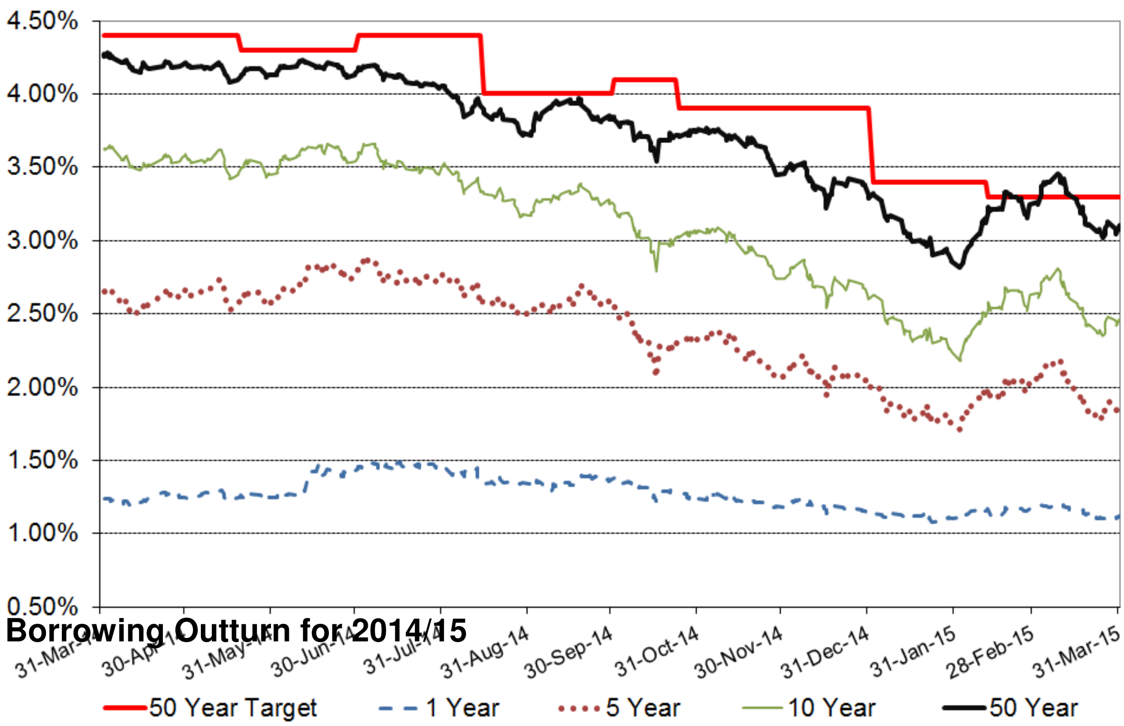
Borrowing Requirement

5.12 The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).

	31 March 2014 Actual	31 March 2015 Budget	31 March 2015 Actual
Capital Financing Requirement	**£97.734m**	**£100.839m**	**£97.074m**

Borrowing Rates in 2014/15

5.13 **PWLB borrowing rates** - the graph below shows how PWLB certainty rates have fallen to historically very low levels during the year.

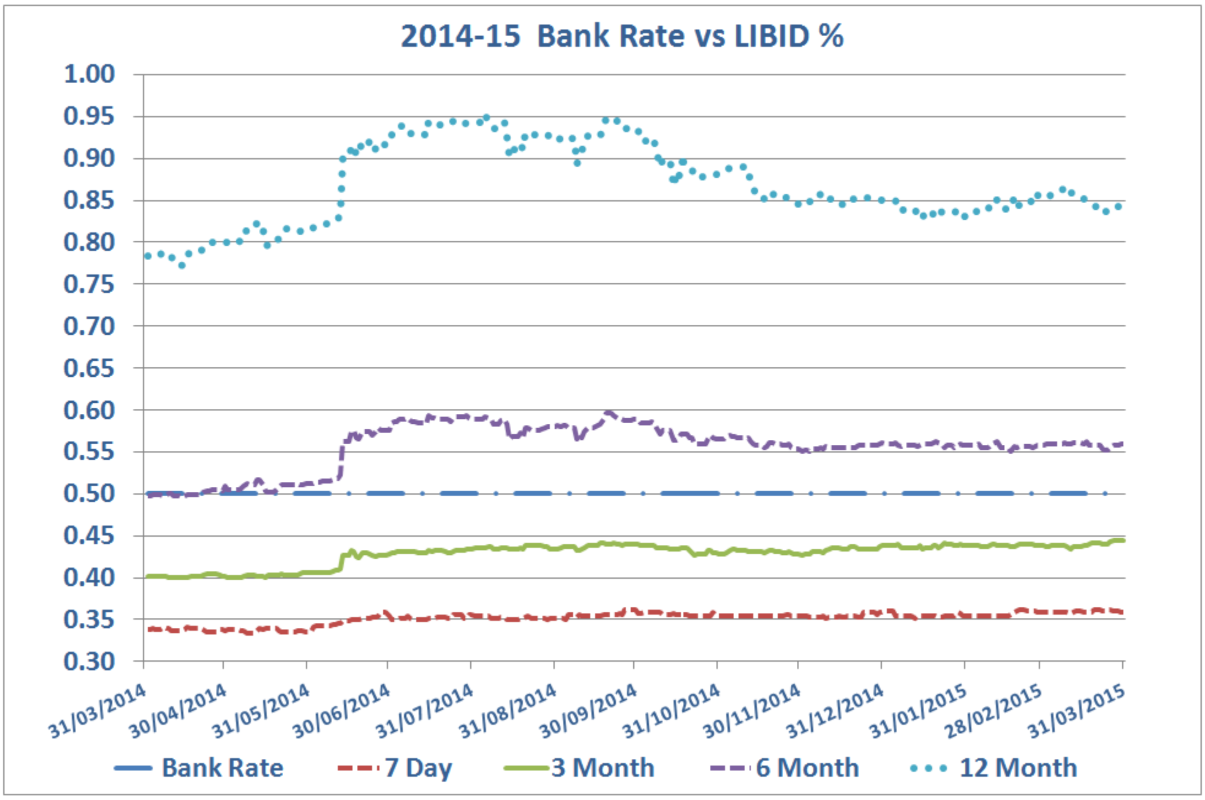


Borrowing Outturn for 2014/15

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

Investment Rates in 2014/15

5.15 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.



Investment Outturn for 2014/15

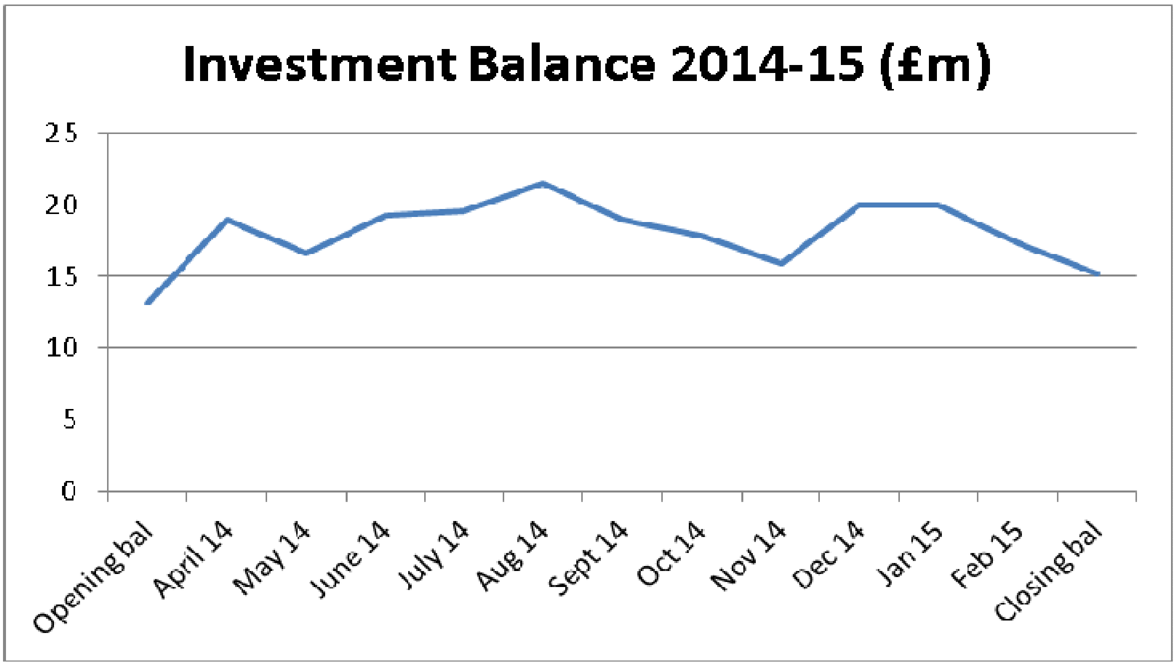
5.16 **Investment Policy** - the Council's investment policy is governed by CLG guidance, which was been implemented in the annual investment strategy approved by the Council on 12 February 2014. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc.).

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

5.18 **Investments as at 31 March 2015** -The Council's investments as at 31 March 2015 are set out in the table below:

Counterparty	Start Date	Maturity	Value (£)	Rate
Natwest Bank plc		Call	3,493,000	0.50%
Ignis (MMF)		Call	2,095,000	0.47%
Federated (MMF)		Call	151,000	0.41%
Royal Bank of Scotland	01/10/14	01/10/15	1,000,000	0.98%
Bank of Scotland plc	19/01/15	18/01/16	1,000,000	1.00%
Bank of Scotland plc	05/03/15	03/03/16	2,724,000	1.00%
Bank of Scotland plc	26/03/15	24/03/16	1,276,000	1.00%
TOTAL			**11,739,000**	**0.75%**

5.19 The chart below illustrates the movement in the level of investments held by the Council at each month end during the year. The peak in year was **£18.8 million** and the average balance for the year was **£13.9 million**.



5.20 The funds earned an average rate of return for the year of **0.75%**. The comparable performance indicator is the average 3 month LIBID rate, which was **0.43%**. The Council's performance exceeds the benchmark by some margin and is a reflection of the success of the strategy of investing a high proportion of the portfolio with UK Banks offering good rates for fixed term deposits of one year.

5.21 Overall investment earnings for the year totalled **£92,000**, which is **£7,000** less than was predicted when the budget was set in February 2014 **(£99,000)**.

6 Implications

6.1 **Financial**

The financial implications have been referred to throughout the report.

6.2 **Legal**

The legal implications have been referred to throughout the report.

6.3 **Human Resources**

There are no human resource implications arising from this report.

6.4 **Section 17 (Crime Prevention)**

There are no implications arising from this report.

6.5 **Human Rights Act**

There are no identified implications in respect of the Human Rights Act 1998 arising from this report.

6.6 **Data Protection**

There are no implications arising from this report.

6.7 **Risk Management**

Treasury Management is a high risk area due to the large amounts of money dealt with on a daily basis. However, the Council has a Treasury Policy and Strategy in place which is approved each year for the following 12 months. The Council also has advice on investment and lending from the leading company in the field and has instituted a strict control and delegation of duties regime which reduces all risks to a minimum.

6.8 **Equality & Diversity**

There are no identified implications arising form this report.

6.9 **Best Value**

The strategy ensures that best value is provided to the Council.

7 Appendices to the Report

Appendix	2014/15 Prudential and Treasury Indicators

Previous Consideration

Nil

Background Papers

Available in Financial Services

ITEM NO. 11.9

APPENDIX

AUDIT AND GOVERNANCE COMMITTEE

23 JUNE 2015

Annual Treasury Management Report 2014/15

1. PRUDENTIAL INDICATORS	2013/14	2014/15	2014/15
	actual	estimate	actual
	£'000	£'000	£'000
Capital Expenditure	15,915	17,812	12,438
Ratio of financing costs to net revenue stream (GF)	4.4%	6.4%	5.4%
Gross debt	88,836	93,421	85,895
Capital Financing Requirement as at 31 March	97,734	100,839	97,074
2. TREASURY MANAGEMENT INDICATORS			
Authorised Limit for external debt -	103,270	106,289	106,289
Operational Boundary for external debt	98,274	100,839	100,839
Actual external debt	88,836	93,421	85,895
Upper limit for fixed interest rate exposure	100%	100%	100%
Upper limit for variable rate exposure	75%	75%	75%
Upper limit for total principal sums invested for over 364 days	£10 million	£10 million	£10 million

Maturity structure of fixed rate borrowing during 2014/15	upper limit	lower limit
under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%