Appendix A

Annual Treasury Management Review

2014/15

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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 full Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 5th February 2014)
- a mid-year (minimum) treasury update report (Council 16th December 2014)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

In addition, Members have received quarterly treasury management update reports as part of the Members Newsletter.

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 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 Budget & Strategic Planning Working Group before they were reported to the full Council. Member training on treasury management issues has also been undertaken 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 £m	2014/15 Original £m	2014/15 Actual £m
Capital expenditure			
• Non-HRA	1.542	1.276	0.909
• HRA	2.011	2.273	2.282
• Total	3.553	3.549	3.191
Capital Financing Requirement:			
• Non-HRA	0.163	0.151	0.151
• HRA	31.876	31.484	31.484
• Total	32.039	31.635	31.635
Gross borrowing	31.861	31.413	31.413
External debt	31.861	31.413	31.413
Investments	Investments of £14.7m are for less than one year	Investments of £11.4m are for less than one year	Investments of £16.45m are for less than one year
Net borrowing	17.161	20.013	14.963

Other prudential and treasury indicators are to be found in the main body of this report. The Head of Central Services also confirms that borrowing was only undertaken for a capital purpose and the statutory borrowing limit (the authorised limit) was not breached.

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 debt activity; and
- Detailed investment activity.

1. The Council's Capital Expenditure and Financing 2014/15

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.

General Fund	2013/14 Actual £m	2014/15 Estimate £m	2014/15 Actual £m
Capital expenditure	**1.542**	**1.276**	**0.909**
Financed in year	1.542	1.276	0.909
Unfinanced capital expenditure	**0**	**0**	**0**

HRA	2013/14 Actual £m	2014/15 Estimate £m	2014/15 Actual £m
Capital expenditure	**2.011**	**2.273**	**2.282**
Financed in year	2.011	2.273	2.282
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. 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.

Reducing the CFR – the Council's (non HRA) 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 non-Housing Revenue Account (HRA) borrowing need (there is no statutory requirement to reduce the HRA CFR). 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).

The Council's 2014/15 MRP Policy (as required by CLG Guidance) was approved as part of the Treasury Management Strategy Report for 2014/15 on 5th February2014.
The Council's CFR for the year is shown below, and represents a key prudential indicator.

CFR General Fund	31 March 2014 Actual £m	31 March 2015 Budget £m	31 March 2015 Actual £m
Opening balance	0.176	0.163	0.163
Add unfinanced capital expenditure (as above)	0	0	0
Less MRP/VRP*	-0.013	-0.012	-0.012
Less PFI & finance lease repayments	0	0	**0**
Closing balance	0.163	0.151	**0.151**

CFR HRA	31 March 2014 Actual £m	31 March 2015 Budget £m	31 March 2015 Actual £m
Opening balance	31.890	31.876	31.876
Add unfinanced capital expenditure (as above)	0	0	0
Less VRP*	-0.014	-0.014	-0.014
Less PFI & finance lease repayments	0	0	**0**
Less Debt repayments	0	-0.378	**-0.378**
Closing balance	31.876	31.484	31.484

** Includes voluntary application of capital receipts*

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

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 allowed the Council some flexibility to borrow in advance of its immediate capital needs in 2014/15. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

	31 March 2014 Actual £m	31 March 2015 Budget £m	31 March 2015 Actual £m
Gross borrowing position	31.861	31.413	31.413
CFR	32.039	31.635	31.635

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 £m
Authorised limit	45.000
Maximum gross borrowing position	31.861
Operational boundary	35.012
Average gross borrowing position	31.860
Financing costs as a proportion of net revenue stream-GRF	-1.63%
Financing costs as a proportion of net revenue stream-HRA	14.51%

3. Treasury Position as at 31 March 2015

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 detailed in the summary, and through officer activity detailed in the Council's Treasury Management Practices. At the end of 2014/15 the Council's treasury (excluding borrowing by PFI and finance leases) position was as follows:

TABLE 1	31 March 2014 Principal £m	Rate/ Return %	Average Life yrs	31 March 2015 Principal £m	Rate/ Return %	Average Life yrs
Fixed rate funding:						
-PWLB	31.861	3.68	34	31.413	3.68	34
-Market	0	0	0	0	0	0
Variable rate funding:						
-PWLB	0	0	0	0	0	0
-Market	0	0	0	0	0	0
Total borrowing	31.861	3.68	34	31.413	3.68	34
CFR	***32.039***	***N/A***	***N/A***		***N/A***	***N/A***
Over / (under) borrowing	***-0.178***	***N/A***	***N/A***		***N/A***	***N/A***
Investments:						
- in house	14.7	0.42	Under 1 yr	16.45	0.61	Under 1 yr
- with managers	0	0	N/A	0	0	N/A
Total investments	***14.7***	***0.42***	***Under 1 yr***	***16.45***	***0.61***	***Under 1yr***

The maturity structure of the debt portfolio was as follows:

	31 March 2014 Actual £m	31 March 2015 Actual £m
Under 12 months	0.448	0
12 months and within 24 months	0	0
24 months and within 5 years	0	0
5 years and within 10 years	0	0
10 years and within 20 years	4.698	4.698
20 years and within 30 years	5.000	5.000
30 years and within 40 years	10.340	10.340
40 years and within 50 years	11.375	11.375

The maturity structure of the investment portfolio was as follows:

	2013/14 Actual £m	2014/15 Original £m	2014/15 Actual £m
Investments	14.7 under one year	11.4 under one year	16.45 under one year

The exposure to fixed and variable rates was as follows:

	31 March 2014 Actual £m	2014/15 Original Limits £m	31 March 2015 Actual £m
Fixed rate (principal or interest)	18.5	38	16.3
Variable rate (principal or interest)	-3.5	7	-1.35

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.

In this scenario, the treasury strategy was not to undertake any borrowing to avoid the cost of holding higher levels of investments and to reduce counterparty risk.

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.

Change in strategy during the year – the have been no revisions in year to the strategy adopted in the original Treasury Management Strategy Report for 2014/15 and approved by the Council on 5th February 2014.

5. The Economy and Interest Rates

The Council's Treasury Management Advisors have provided the following narrative on 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, 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. Fears also increased considerably that the European Central Bank was going to do too little too late to ward off the threat of deflation and recession in the Eurozone. 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 Monetary Policy Committee (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.

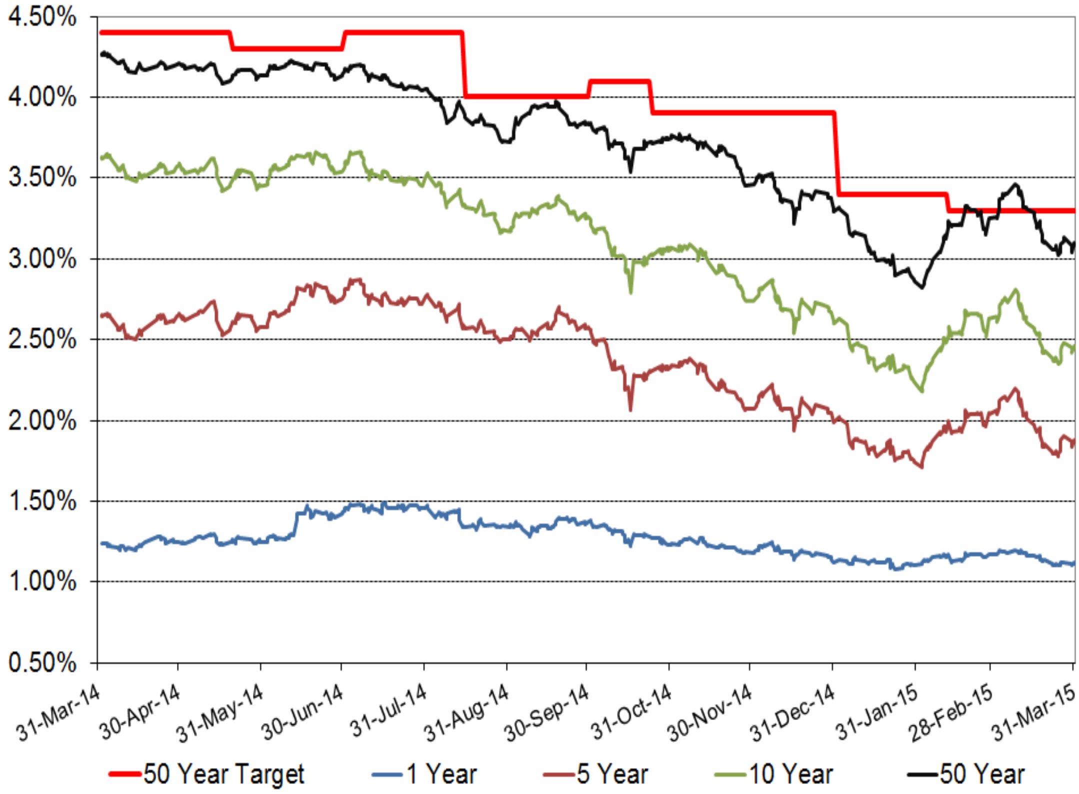
The Funding for Lending Scheme, announced in July 2012, resulted in a flood of cheap credit being made available to banks which then resulted in money market investment rates falling drastically in the second half of that year and continuing throughout 2014/15.

The UK coalition Government maintained its tight fiscal policy stance but recent strong economic growth and falling gilt yields led to a reduction in the forecasts for total borrowing in the March budget.

The EU sovereign debt crisis had subsided since 2012 until the Greek election in January 2015 sparked a resurgence of fears. While the UK and its banking system has little direct exposure to Greece, it is much more difficult to quantify quite what effects there would be if contagion from a Greek exit from the euro were to severely impact other major countries in the Eurozone and cause major damage to their banks.

6. Borrowing Rates in 2014/15

PWLB certainty maturity borrowing rates - the graphs and table for PWLB rates below and in appendix 3, show, 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 the end of the financial year.



7. Borrowing Outturn for 2014/15

Treasury Borrowing – there was no requirement for any short term borrowing during the year.

Borrowing – the Council had no requirement to undertake any borrowing due to the current levels of receipts maintained comparative to the capital expenditure plans.

Rescheduling

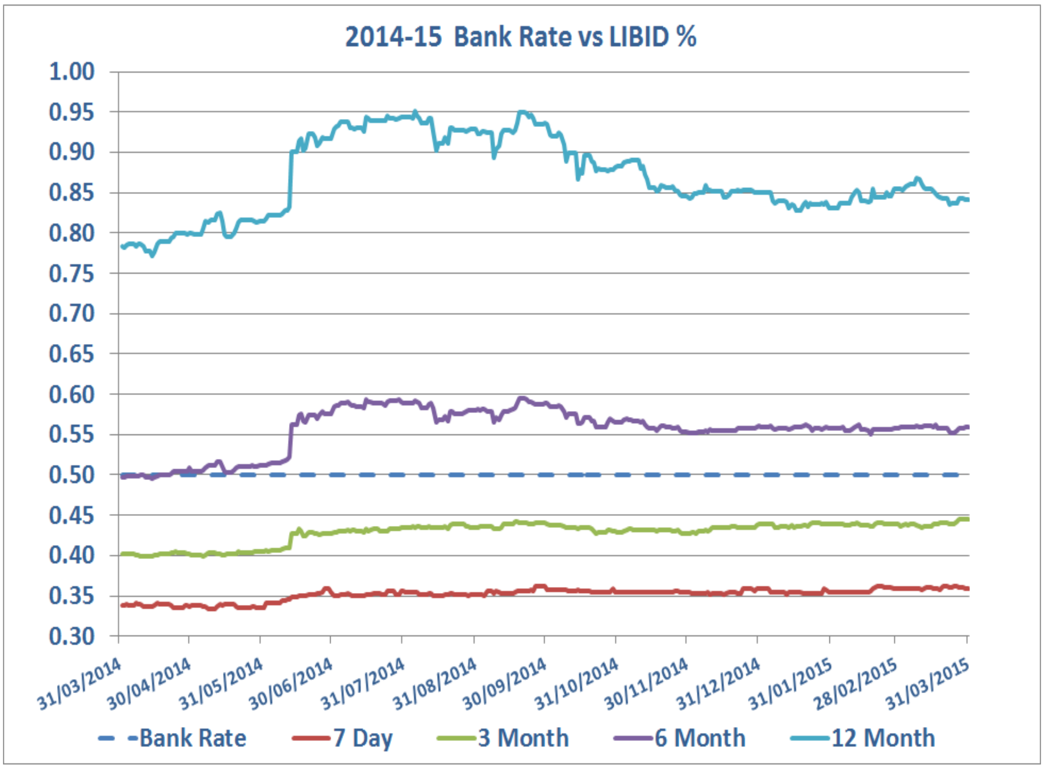
No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

Repayments
On 28th March 2015 the Council repaid £448,000 at a rate of 0.75% which was due for maturity.

Summary of debt transactions – the average interest rate on the debt portfolio remained unchanged at 3.68%.

8. 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.



9. Investment Outturn for 2014/15

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 5th 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.

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

Balance Sheet Resources	31 March 2014 £m	31 March 2015 £m
Balances	**2.206**	**1.984**
Earmarked reserves	**4.784**	**6.553**
Provisions	**0.259**	**0.218**
Usable capital receipts	**6.823**	**6.353**
Total	**14.072**	**15.108**

Investments held by the Council - the Council maintained an average balance of £19.4m of internally managed funds. The internally managed funds earned an average rate of return of 0.61%. The comparable performance indicator is the average 7-day money market rate, which was 0.33%. This compares with a budget assumption of £11.36m investment balances earning an average rate of 0.40%.

10. Performance Measurement

One of the key requirements in the Code is the formal introduction of performance measurement relating to investment activities. The Council's performance indicators were set out in the Annual Treasury Management Strategy.

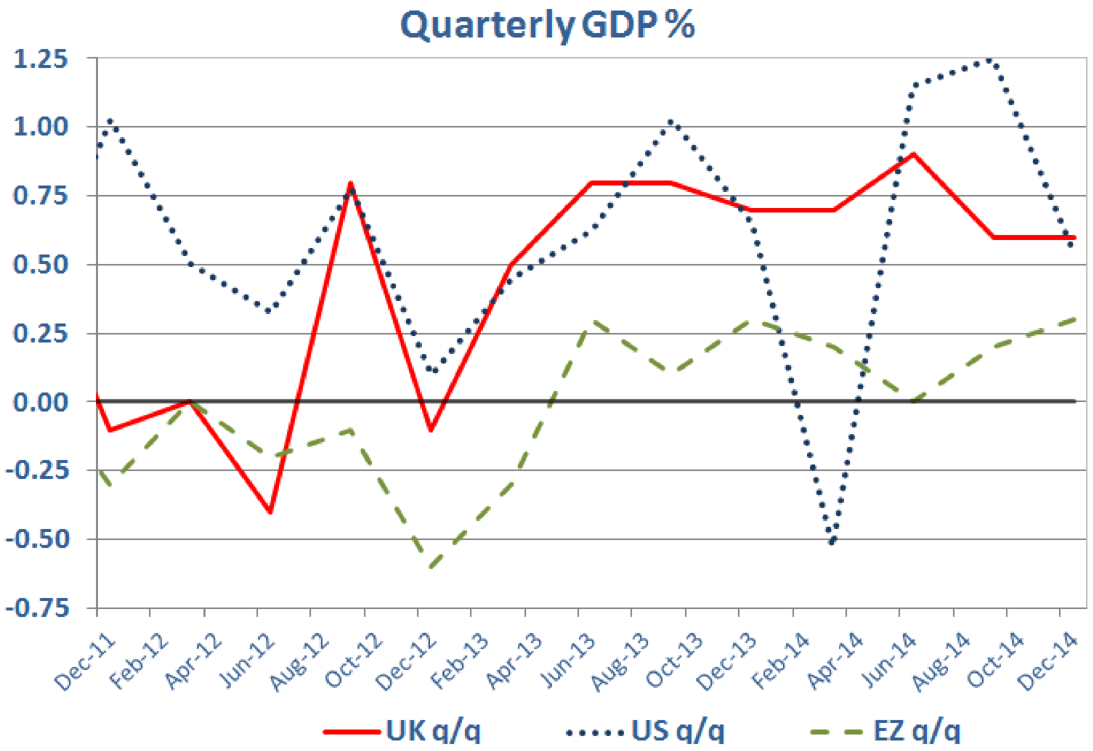
This service has set the following performance indicators:

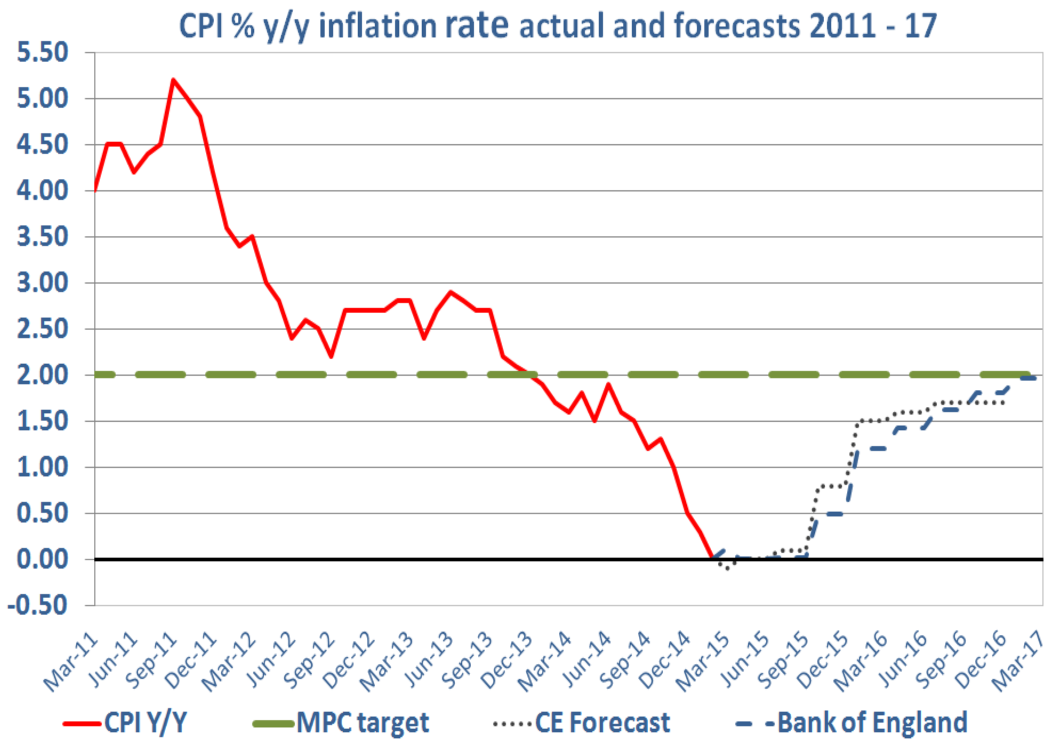
Investments—to achieve a return on external investments in excess of the seven day money market rate. In 2014-15 the rate of return was 0.61% compared to the money market rate of 0.33%

11. Other Issues

The investment portfolio has now changed to incorporate more diversification in terms of both counterparty and maturity. As interest rates are currently at low levels it is not a good time to be locking funds into very long term investments and therefore the recent lengthening of the portfolio out to twelve months is currently as far as is reasonable.

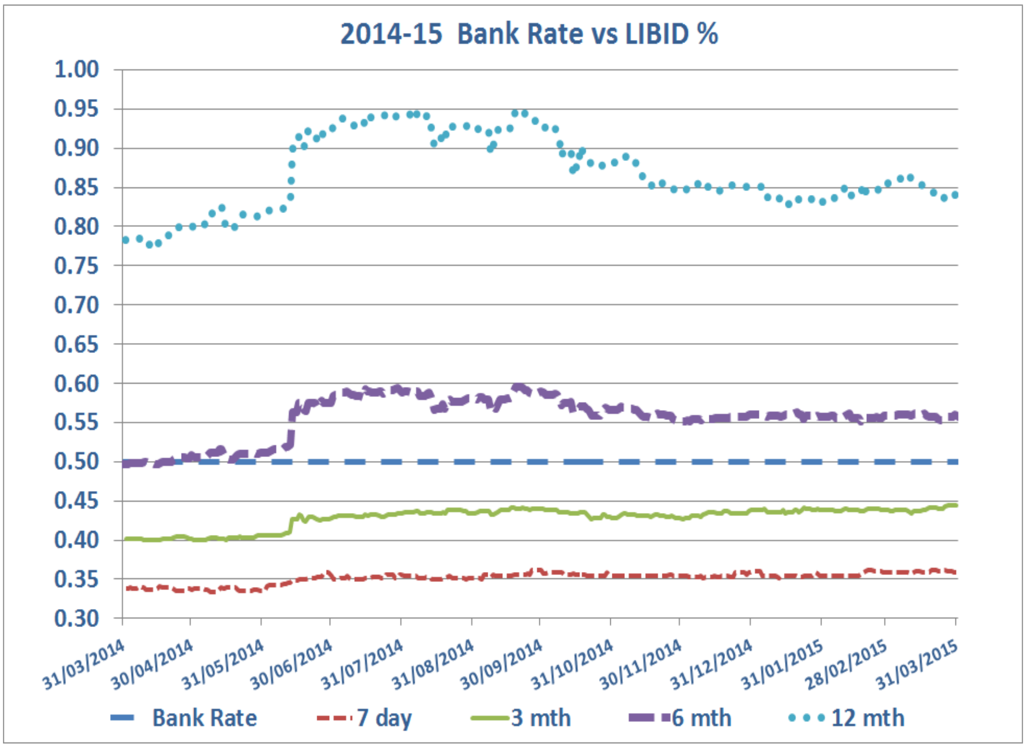
Appendix 2: Graphs

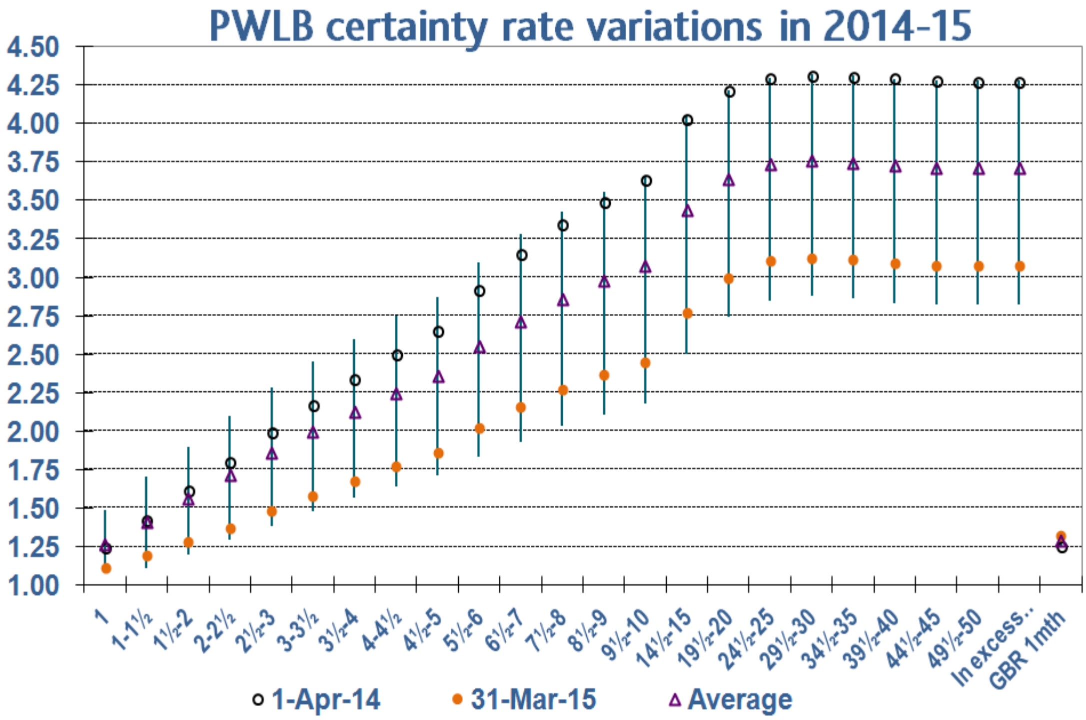




Appendix 3: Borrowing and investment rates

Money market investment rates 2014/15					
	7 day	1 month	3 month	6 month	1 year
1/4/14	0.338	0.362	0.402	0.497	0.783
31/3/15	0.358	0.378	0.445	0.559	0.841
High %	0.362	0.384	0.445	0.596	0.951
Low %	0.334	0.360	0.400	0.496	0.772
Average %	0.352	0.374	0.429	0.556	0.868
Spread %	0.028	0.024	0.045	0.100	0.180
High date	26/3/15	26/9/14	27/3/15	19/9/14	5/8/14
Low date	8/5/14	4/4/14	9/4/14	14/4/14	14/4/14





	1	1-1.5	2.5-3	3.5-4	4.5-5	9.5-10	24.5-25	49.5-50	1 month variable
1/4/14	1.240%	1.420%	1.990%	2.340%	2.650%	3.630%	4.290%	4.270%	1.250%
31/3/15	1.110%	1.190%	1.480%	1.680%	1.860%	2.450%	3.110%	3.080%	1.320%
High	1.490%	1.700%	2.280%	2.600%	2.870%	3.660%	4.300%	4.280%	1.340%
Low	1.080%	1.110%	1.380%	1.570%	1.710%	2.180%	2.850%	2.820%	1.250%
Average	1.266%	1.417%	1.863%	2.130%	2.362%	3.083%	3.737%	3.719%	1.290%
Spread	0.410%	0.590%	0.900%	1.030%	1.160%	1.480%	1.450%	1.460%	0.090%
High date	16/07/2014	03/07/2014	03/07/2014	03/07/2014	03/07/2014	20/06/2014	03/04/2014	02/04/2014	17/09/2014
Low date	23/01/2015	06/01/2015	07/01/2015	07/01/2015	02/02/2015	02/02/2015	02/02/2015	02/02/2015	01/04/2014

	1 Year	5 Year	10 Year	25 Year	50 Year
1/4/14	1.24%	2.65%	3.63%	4.29%	4.27%
31/3/15	1.11%	1.86%	2.45%	3.11%	3.08%
Low	1.08%	1.71%	2.18%	2.85%	2.82%
Date	23/01/2015	02/02/2015	02/02/2015	02/02/2015	02/02/2015
High	1.49%	2.87%	3.66%	4.30%	4.28%
Date	16/07/2014	03/07/2014	20/06/2014	03/04/2014	02/04/2014
Average	1.27%	2.36%	3.08%	3.74%	3.72%