TREASURY MANAGEMENT ANNUAL REPORT 2014/15

1. INTRODUCTION AND BACKGROUND

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 Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

The CIPFA Code of Practice on Treasury Management 2009 was adopted by this Council on 24 February 2010.

The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
3. Receipt by the Full Council of an annual treasury management strategy report (including the annual investment strategy) for the year ahead and an annual review report of the previous year.
4. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
5. Delegation by the Council of the role of scrutiny of the treasury management strategy to a specific named body which in this Council is the Finance, Resources and Partnerships Scrutiny Committee.
6. Delegation by the Council of the role of scrutiny of treasury management performance to a specific named body which in this Council is the Audit and Risk Committee, a midyear and year end review report is received by this Committee.

Treasury management in this context is defined as:

"The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks. "

The purpose of this report is to meet one of the above requirements of the CIPFA Code, namely the annual review report of treasury management activities, for the financial year 2014/15.

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 has complied with the requirement under the Code to give prior scrutiny to the annual review report by reporting this to the Audit and Risk Committee prior to it being reported to Full Council.

2. THIS ANNUAL TREASURY REPORT COVERS

- The Council's treasury position as at 31st March 2015;
- The strategy for 2014/15;
- The economy in 2014/15;
- Investment rates in 2014/15;

- Compliance with treasury limits and Prudential Indicators;
- Investment outturn for 2014/15;
- Involvement of Elected Members;
- Other issues.

3. TREASURY POSITION AS AT 31 MARCH 2015

The Council's investment position at the beginning and the end of the year was as follows:

	At 31/3/15	Return	Average Life (Days)	At 31/3/14	Return	Average Life (Days)
Total Debt	***£0m***	***N/A***	***N/A***	***£0m***	***N/A***	***N/A***
Total Investments	***£8.8m***	***0.46%***	***7***	***£3.55m***	***0.69%***	***8***

It should be noted that the above table is only a snapshot of the Total Investments as at 31 March. Large fluctuations in cash inflows and outflows that occur throughout the month can have an impact on the figure reported. The higher figure for investments for 31 March 2015 is due to two large receipts being received at the end of the year. In addition there was an underspend on the capital programme.

4. THE STRATEGY FOR 2014/15

The strategy agreed by Council on 26 February 2014 was that:

- The Council's Borrowing Need (Capital Financing Requirement) was estimated at £3,000,000 for 2014/15, rising to £10m in future years, to allow for the possibility that the Council may need to borrow to finance capital expenditure which cannot be funded from other revenue or capital resources;

- Short term borrowing would be required in the event to cover any temporary shortfalls in revenue income or to temporarily fund capital expenditure during the interim period before a permanent means of finance became available;

- All borrowing would be kept absolutely within the Authorised Limit of £15m and would not normally exceed the Operational Boundary of £8m (although it could for short periods of time be permitted to rise to a figure between £8m and £15m due to variations in cash flow);

- Temporary surpluses which might arise would be invested, either in short term deposits with the Council's various deposit accounts or in money market investments (cash deposits) if the size warranted this and for an appropriate period in order that these sums would be available for use when required;

- The proportions of loans and investments to be at fixed or variable rates were: fixed rate loans to be between 0% and 100% of the total and variable rate to be between 0% and 100% of the total, thus enabling maximum flexibility to take advantage of interest rate trends;

- Long term investments to be permitted as follows: maturing beyond 31/03/15 £5m, maturing beyond 31/03/16 £5m, maturing beyond 31/03/17, £5m;

- The overriding consideration in determining where to place the Council's surplus funds was to safeguard the Council's capital. Within this constraint the aim was to maximise the return on capital; and,

- Forward commitment of funds for investment is permitted in respect of in house investments.

Changes in strategy and credit Policy during the year

There have been no changes to the Treasury Management Strategy during the year. As approved by Council on 26 February 2014 the Council used the creditworthiness service provided by the Council's treasury management advisors, Sector Treasury Services which uses a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moodys and Standard and Poors, forming the core element, supplemented by additional data (credit watches and outlooks, Credit Default Swap (CDS) spreads to give early warning of likely changes in credit ratings and Sovereign ratings to select counterparties from only the most creditworthy countries). This modelling approach results in a weighted scoring system providing a series of colour coded bands which indicate the relative creditworthiness of counterparties and a suggested maximum investment duration.

5. THE ECONOMY AND INTEREST RATES - narrative supplied by the Council's Treasury Management Advisors – Sector Treasury Services Limited

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.

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 European Union and European Central Bank, 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 Eurozone 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 Eurozone government and other debt in March. On the other hand, strong growth in the United States caused an increase in confidence that the United States 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.

6. INVESTMENT RATES IN 2014/15 – narrative supplied by the Council's Treasury Management Advisors – Sector Treasury Services Limited

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.

7. COMPLIANCE WITH TREASURY LIMITS

During the financial year the Council operated within the treasury limits and Prudential Indicators set out in the Council's annual Treasury Strategy Statement. The outturn for the Prudential Indicators is shown in Annex 1.

8. INVESTMENT OUTTURN FOR 2014/15

Internally Managed Investments
The Council manages its investments in-house and invests with institutions in compliance with Sector Treasury Services credit worthiness service. The Council invested for a range of periods from overnight to up to twelve months dependent on the Council's cash flows, its interest rate view and the interest rates on offer. Six of the seventeen fixed investments (excluding use of the Government's Debt Management Office Debt Management Account Deposit Facility) made in 2014/15 were for a period of three months, with ten fixed investments being for less than three months. The remaining fixed investment is for twelve months and is not yet due to mature until mid 2015/16.

The Council used the Government's Debt Management Office (DMO) Debt Management Account Deposit Facility (DMADF) on forty one occasions during the year with the longest deposit being made for twenty one days.

Aside from fixed investments and use of the DMO DMADF, the Council used its various deposit accounts on a frequent basis.

Investment Outturn for 2014/15

During 2014/15 an average rate of return of 0.46% was achieved on an average individual investment of £1.47m. This compared with the target of 0.50% included in the departmental service plan.

9. INVOLVEMENT OF ELECTED MEMBERS

Elected members have been involved in the treasury management process during 2014/15 including:

- Scrutiny of the treasury management strategy by the Finance, Resources and Partnerships
- Committee prior to being submitted for approval by the Full Council.
- Scrutiny of treasury management performance by the Audit and Risk Committee through the receipt of a half yearly treasury management report.
- A quarterly budget monitoring and performance report is reported to Cabinet, this contains details of Treasury Management activity undertaken during the quarter.

10. HERITABLE BANK DEFAULTS

This authority currently has the following investment frozen in the Heritable Bank:

- Investment 5092, £2.5m, maturity date 14 September 2009.

Payments up to 31 March 2015 totalled £2,357,691 (94% return of principal invested).

11. BANKING SERVICES CHANGE

As at 10 December 2014 the Council appointed Lloyds Bank for the provision of banking services. Given the potential value of the contract the tender for the Council's banking services was advertised via the Eastern Shires Purchasing Organisation (ESPO) framework.

The contract is due to run until 30 November 2017, with a further option to extend annually by two years with Cabinet approval

This change from the Co-Operative Bank to Lloyds Bank was necessary due to the Council receiving notification from the Co-Operative Bank in November 2013 that they had decided to withdraw its involvement in providing banking transmission services to local authorities as a result of their plan to simplify and rebuild the Bank focusing on serving the needs of individuals and small and medium sized business customers. The Co-Operative Bank stated that the decision was not taken lightly but that they feel it is necessary as they seek to put foundations in place to support the longer term stability of the Bank.

As the provision by the Co-Operative Bank ceased at 31 March 2015, the Council was able to run two concurrent accounts ensuring that the Council received all payments due, even if still sent to the old account. Notifications were made to both residents and organisations to ensure that transactions were undertaken with the Lloyds Bank account going forward.

ANNEX 1: PRUDENTIAL INDICATORS

	Position/Prudential Indicator	2013/14 Actual	2014/15 Original Indicator	2014/15 Actual
1	Capital Expenditure	£3.283m	N/A	£2.061m
2	Capital Financing Requirement at 31st March	(£0.360m)	£3m	(£0.503m)
3	Treasury Position at 31st March: Borrowing Other long term liabilities Total Debt Investments Net Borrowing	 £0.0m £0.3m £0.3m (£3.558m) (£3.258m)	 N/A N/A N/A N/A N/A	 £0 £0.147m £0.147m (£8.808m) (£8.661m)
4	Authorised Limit (against maximum position)	£2.75m	£15.0m	£0
5	Operational Boundary (against maximum position)	£2.75m	£8.0m	£0
6	Ratio of Financing Costs to Net Revenue Stream	(0.48%)	0.02%	(0.27%)
7	Upper Limits on Variable Interest Rates (against maximum position) Loans Investments	 0% 0%	 100% 100%	 0 0
8	Actual External Debt	£0.0m	N/A	0
9	Principal Funds Invested for Periods Longer than 364 days (against maximum position)	£0.0m	£5.0m	0

GLOSSARY

CPI – Consumer Price Index

The Consumer Price Index (CPI) is the main UK measure of inflation for macroeconomic purposes and forms the basis for the Government's inflation target. It is also used for international comparisons.

DMO and DMADF - Debt Management Office and Debt Management Account Deposit Facility

The DMO is an Executive Agency of Her Majesty's Treasury. The DMO provides the DMADF to support local authorities' cash management by providing a flexible and secure facility to supplement their existing range of investment options whilst saving interest costs for Central Government.

ECB – European Central Bank

The European Central Bank (ECB) is the central bank for the euro and administers the monetary policy of the EU member states which constitute the Eurozone, one of the largest currency areas in the world.

MPC – Monetary Policy Committee

Interest rates are set by the Bank's Monetary Policy Committee (MPC). The MPC sets an interest rate it judges will enable the inflation target to be met. The Bank's MPC is made up of nine members – the Governor, the two Deputy Governors, the Bank's Chief Economist, the Executive Director for Markets and four external members appointed directly by the Chancellor. The appointment of external members is designed to ensure that the MPC benefits from thinking and expertise in addition to that gained inside the Bank of England.

PWLB – Public Works Loan Board

The Public Works Loan Board (PWLB) is a statutory body operating within the Debt Management Office and is responsible for lending money to local authorities and other prescribed bodies, as well as for collecting the repayments.

QE – Quantitative Easing

Quantitative Easing is an unconventional monetary policy used by central banks to stimulate the national economy when standard monetary policy has become ineffective. A central bank implements quantitative easing by buying financial assets from commercial banks and other private institutions, thus increasing the money supply by flooding financial institutions with capital, in an effort to promote increased lending and liquidity.