TREASURY MANAGEMENT ANNUAL REPORT 2015/16

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 the financial year 2015/16. 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; this was updated in November 2011.

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 2015/16.

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 31 March 2016;
- The strategy for 2015/16;
- The economy in 2015/16;

- Investment rates in 2015/16;
- Compliance with treasury limits and Prudential Indicators;
- Investment outturn for 2015/16;
- Involvement of Elected Members;
- Other issues.

3. TREASURY POSITION AS AT 31 MARCH 2016

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

	At 31/03/16	Return	Average Life (Days)	At 31/03/15	Return	Average Life (Days)
Total Debt	*£0m*	*N/A*	*N/A*	*£0m*	*N/A*	*N/A*
Total Investments	*£7.5m*	*0.68%*	*11*	*£8.8m*	*0.46%*	*7*

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 high figure for investments for 31 March 2016 is due to an underspend on the capital programme.

4. THE STRATEGY FOR 2015/16

The strategy agreed by Council on 25 February 2015 was that:

- The Council's Borrowing Need (Capital Financing Requirement) for 2015/16 was estimated at £360,000 due to the Council expecting to have funds available and no borrowing requirement, rising to £1m 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 external loans (i.e. repayable on demand or within 12 months) can be taken to fund any temporary capital or revenue borrowing requirement. The amounts involved would fluctuate according to the cash flow position at any one time;

- All borrowing would be kept absolutely within the Authorised Limit of £15m and would not normally exceed the Operational Boundary of £5m (although it could for short periods of time be permitted to rise to a figure between £5m 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 31/03/16 £5m, maturing beyond 31/03/17 £5m, maturing beyond 31/03/18, £5m;

- The overriding consideration is safeguarding the Council's capital. At all times the risk to the Council will be minimised. Within these constraints, the aim will be to maximise the return on investments; and,

- Forward commitment of funds for investment is permitted in respect of in house investments, in instances where market conditions warrant it.

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 25 February 2015 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

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. 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.

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.

6. INVESTMENT RATES IN 2015/16 – 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 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.

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 2015/16

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 six months during 2015/16, dependent on the Council's cash flows, its interest rate view and the interest rates on offer. Seven of the fourteen fixed investments (excluding use of the Government's Debt Management Office Debt Management Account Deposit Facility) made in 2015/16 were for a period of three months or less. Six fixed investments were for six months. The remaining investment was a twelve month investment that was carried over from 2014/15.

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

Aside from fixed investments and use of the DMO DMADF, the Council used its various deposit accounts. This included two deposits in a 32 day notice account, four deposits in a 95 day notice account and one deposit in a 180 day notice account. On four occasions funds were also deposited in the Council's business reserve account. Funds in the general fund account that the Council has with Lloyds Bank also earns interest on a daily basis.

Investment Outturn for 2015/16

During 2015/16 an average rate of return of 0.68% was achieved on an average individual investment of £2.11m. This compared with the target of 0.45% included in the departmental service plan.

9. INVOLVEMENT OF ELECTED MEMBERS

Elected members have been involved in the treasury management process during 2015/16 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 2016 totalled £2,457,623 (98% return of principal invested).

ANNEX 1: PRUDENTIAL INDICATORS

	Position/Prudential Indicator	2014/15 Actual	2015/16 Original Indicator	2015/16 Actual
1	Capital Expenditure	£2.061m	N/A	£2.543m
2	Capital Financing Requirement at 31st March	(£0.503m)	(£0.360m)	(£0.895m)
3	Treasury Position at 31st March: Borrowing Other long term liabilities Total Debt Investments Net Borrowing	 £0 £0.155m £0.155m (£8.808m) (£8.653m)	 N/A N/A N/A N/A N/A	 £0 £0m £0m (£7.549m) (£7.549m)
4	Authorised Limit (against maximum position)	£0	£15.0m	£0
5	Operational Boundary (against maximum position)	£0	£5.0m	£0
6	Ratio of Financing Costs to Net Revenue Stream	(1.48%)	(0.37%)	(1.92%)
7	Upper Limits on Variable Interest Rates (against maximum position) Loans Investments	 0 0	 100% 100%	 0 0
8	Actual External Debt	0	N/A	0
9	Principal Funds Invested for Periods Longer than 364 days (against maximum position)	0	£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.