APPENDIX 1

Annual Treasury Management Report 2014/15

Purpose

This Council is required through regulations issued under the Local Government Act 2003 to produce an annual treasury report reviewing treasury management 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 full Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 24/2/2014)
- a mid year treasury update report (Accounts, Audit & Risk Committee 03/12/14)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

The Accounts, Audit and Risk Committee has been nominated to scrutinise the treasury activity of the Council and it receives regular reports. In addition, this Council has received quarterly treasury management update reports by the Executive.

Recent changes in the regulatory environment place a much greater onus on members for the review and scrutiny of treasury management policy and activities. This report is 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 also 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 Accounts, Audit & Risk Committee before they were reported to the full Council.

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 £000	2014/15 Actual £000
Capital expenditure	7,451	18,185
Capital Financing Requirement:	(7,451)	(18,185)
Net borrowing	0	0
External debt	0	0
Investments • Longer than 1 year • Under 1 year • Total	 0 56,453 **56,453**	 0 49,853 **49,853**

Other prudential and treasury indicators calculated at the time of preparing our Treasury Strategy for 2014/15 are to be found in Annex 1 of this report. .

The financial year 2014/15 continued the challenging investment environment of previous years, namely low investment returns and continuing heightened levels of counterparty risk.

Introduction and Background

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 the impact on investment balances;
- Summary of interest rate movements in the year;
- 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:

	2013/14 Actual £000s	**2014/15 Actual £000s**
Capital Expenditure	7,451	18,185
Total Capital expenditure	**7,451**	**18,185**
Resourced by		
Capital receipts	(6,585)	(17,762)
Government Grants & Other Contributions	(539)	(389)
Use of Reserves	(327)	(34)
Direct Revenue Financing		-
Total resources used	**7,451**	**18,185**

2. The Council's Overall Borrowing Need

The Council is debt free and does not currently have a borrowing requirement.

3. Treasury Position as at 31 March 2015

The Council's investment position is organised by the treasury management team 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 beginning and the end of 2014/15 the Council's treasury position was as follows:

	2013/14 Actual £000	2014/15 Actual £000
Investments		
Longer than 1 year	0	-
Under 1 year	56,453	49,853
Total	**56,453**	**49,853**

4. The Strategy for 2014/15

The Treasury Management Strategy Statement (TMSS) for 2014/15, which includes the Annual Investment Strategy, was approved by the Council on 24/2/2014. It sets out the Council's investment priorities as being:

- **Security of capital;**
- **Liquidity; and**
- **Yield**

The Council will also aim to achieve the optimum return (yield) on investments commensurate with proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term to cover short term cash flow needs but also to seek out value available in significantly higher rates in periods up to 12 months with highly credit rated financial institutions, using Capita Asset Services suggested creditworthiness approach, including sovereign credit rating and Credit Default Swap (CDS) overlay information provided by Sector.

5. The Economy

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 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.

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.

EU	*European Union*
ECB	*European Central Bank*
EZ	*Eurozone*
MPC	*Monetary Policy Committee*

5. Interest Rate Forecast

The Council's treasury advisor, Capita Asset Services, provides the following forecast:

Capita Asset Services Interest Rate View

	Now	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17
Capita Asset Services Bank Rate View	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%
3 Month LIBID	0.39%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.60%	0.70%	0.90%	1.00%
6 Month LIBID	0.47%	0.60%	0.60%	0.60%	0.60%	0.60%	0.60%	0.60%	0.60%	0.60%	0.70%	0.80%	1.00%	1.20%	1.40%
12 Month LIBID	0.75%	0.80%	0.80%	0.80%	0.80%	0.80%	0.80%	0.80%	0.90%	1.00%	1.20%	1.40%	1.60%	1.80%	2.00%
5yr PWLB Rate	2.38%	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.80%	2.90%	3.00%	3.20%	3.30%	3.50%	3.60%	3.70%
10yr PWLB Rate	3.52%	3.70%	3.70%	3.70%	3.80%	3.80%	3.90%	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.60%	4.60%
25yr PWLB Rate	4.29%	4.40%	4.40%	4.40%	4.50%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.10%	5.10%	5.20%
50yr PWLB Rate	4.33%	4.40%	4.40%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%	5.20%	5.20%	5.30%

Capita Asset Services undertook a review of its interest rate forecasts in February, after the Bank of England's latest quarterly Inflation Report. This latest forecast now includes a first increase in Bank Rate in quarter 3 of 2016 (previously quarter 4 of 2015), and reflects greater caution as to the speed with which the MPC will start increasing Bank Rate than the current expectations of financial markets.

6. Investment Outturn for 2014/15

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 24/02/2014. 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.

Investments held by fund managers

In 2013/14 the Council decided to recall the monies managed by Investec and manage it in house. Therefore, there were no funds held with fund managers at the end of 2014/15.The performance of the managers against the benchmark return was:

Fund Manager	Balance 01/04/2014 £'000	Balance 31/03/15 £'000	Return in 2014/15 £'000
In House	56,453	49,853	.65%
Investec	0	0.00	0
Total	**£56,453**	**£49,853**	

** Excludes Glitinir Bank outstanding investment ** Rate of Return is shown on annualised basis*

The actual return on investments for 2014/15 was £400k compared with a budget of £48k a positive variance of £352k. However approximately £42k of the interest received is in respect of the investment of Eco Town funds and this has been allocated back to the Eco Town funding pot.

7. Icelandic Bank Defaults

The Council was one of over 100 local authorities that were affected by the collapse of Icelandic banking institutions. The Council held a total of £6.5 million in 3 investments with Glitnir.

As reported previously out of the £6.5m original capital investment £5.7m has been returned to the Council. The remaining balance of £729k and the associated interest relating to the investment are still held within Iceland and continuing to accrue interest on an annual basis. The carrying value of the investment in GBP including accrued interest at 31 March 2015 was £1.468m. The carrying value at 31 March 2014 was £1.536m. The reduction in value of £68K is represented by a combination of interest earned and a loss due to the foreign exchange rate conversion from ISK to GBP.

We continue to have discussions with the LGA and Bevan Brittan on the potential for transfer to the UK.

Annex 1 Prudential and Treasury Indicators

Investment & Debt Portfolio Position

	31/03/15 Actual Portfolio £m
External Borrowing:	
- Total External Borrowing	0
Other Long Term Liabilities:	
- Finance Leases	0
Total Gross External Debt	**0**
Investments:	
Managed in-house	
- Short-term monies (Deposits/ monies on call / MMFs)	49,853
- Long-term investments	
Managed externally	
- By Fund Managers	0
- Pooled Funds (please list)	0
Total Investments	**49,853**

Background:

It is a requirement under the Local Government Act 2003 for local authorities to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the "CIPFA Prudential Code") when setting and reviewing their Prudential Indicators.

Net Borrowing and the Capital Financing Requirement:

This is a key indicator of prudence. In order to ensure that over the medium-term net borrowing will only be for a capital purposes, the local authority needs to ensure that the net external borrowing does not (except in the short term) exceed the total of the capital financing requirement in the preceding year plus the estimates of any additional increases to the capital financing requirement for the current and next two financial years.

The Director of Resources reports that the authority had no difficulty meeting this requirement in 2014/15, nor is there any difficulties envisaged for future years. This view takes into account current commitments, existing plans and the proposals in the approved budget.

Estimates of Capital Expenditure:

This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits and, in particular, considers the impact on Council Tax.

The Council's capital expenditure plans are summarised below and this forms the first of the prudential indicators. This total expenditure can be paid for immediately by resources such as capital receipts, capital grants etc. However, where these resources are insufficient any residual expenditure will form a borrowing need.

	2014/15 Actual £000s	2015/16 Estimated £000s	2016/17 Estimated £000s	2017/18 Estimated £000s
Capital Expenditure	18,185	27,377	1,625	90
Financed by:				
Capital receipts	(17,762)	(19,746)	(580)	(2,258)
Capital grants	(389)	(457)	(375)	(375)
Reserves funded through Revenue	(34)	0	(400)	0
External Funding	0	0	0	0
Net financing need for the year	0	6,914	670	(2,543)

Ratio of Financing Costs to Net Revenue Stream:

This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs.

The definition of financing costs is set out in the Prudential Code.

The ratio is based on costs net of investment income.

Ratio of Financing Costs to Net Revenue Stream	2013-14 Approved %	2013-14 Actual%	2014-15 Estimate %	2015-16 Estimate %	2016-17 Estimate %
Total	**0**	**0**	**0**	**0**	**0**

Capital Financing Requirement:

The CFR is simply the total outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of Council's underlying borrowing need.

The Council is required to pay off an element of the accumulated General Fund capital spend each year through a revenue charge (the Minimum Revenue Provision), although it is also allowed to undertake additional voluntary payments.

£'000	**2013/14 Actual**	**2014/15 Actual**	**2015-16 Estimate**	**2016/17 Estimate**	**2017/18 Estimate**
Capital Financing Requirement					
Total CFR	**-3,152**	**-5,862**	**27,377**	**27,377**	**27,377**
Movement in CFR	**0**	**2,710**	**27,377**	**0**	**0**
Movement in CFR represented by					
Net financing need for the year (above)	0	2,710	27,377	0	0
Less MRP/VRP and other financing movements	0	0	0	0	0
Movement in CFR	**0**	**2,710**	**27,377**	**0**	**0**

Actual External Debt:

This indicator is obtained directly from the Council's balance sheet. It is the closing balance for actual gross borrowing plus other long-term liabilities. This Indicator is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit.

Actual External Debt as at 31/03/2015	**£m**
Borrowing	0
Other Long-term Liabilities	0
Total	**0**

Incremental Impact of Capital Investment Decisions:

This is an indicator of affordability that shows the impact of capital investment decisions on the Council Tax. The incremental impact is calculated by comparing the total revenue budget requirement of the current approved capital programme with an equivalent calculation of the revenue budget requirement arising from the proposed capital programme.

This reflects the fact that capital expenditure is predominantly financed from internal resources (grants, contributions, revenue and capital receipts) and that any increase in the underlying need to borrow is supported through the Revenue Support Grant system. However, any borrowing undertaken in 2014/15 and 2015/16 that is not supported either through internal funds or central grant will have an incremental impact on Council Tax.

Adoption of the CIPFA Treasury Management Code:

This indicator demonstrates that the Council has adopted the principles of best practice.

Adoption of the CIPFA Code of Practice in Treasury Management
The Council approved the adoption of the CIPFA Treasury Management Code at its Full Council meeting on 27th February 2012.

The Council has incorporated the changes from the revised CIPFA Code of Practice into its treasury policies, procedures and practices.

This Council is aware that there is now a new indicator on net debt which has been considered; however, this is not detailed further as the Council currently has no plans to go into debt during the 2014-15 financial year.

Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure:

These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates.

The upper limit for variable rate exposure has been set to ensure that the Council is not exposed to interest rate rises which could adversely impact on the revenue budget. The limit allows for the use of variable rate debt to offset exposure to changes in short-term rates on investments:

	Existing level (or Benchmark level) at 31/03/14 £m or %	**2014-15 Approved £m or %**	**2014-15 Revised £m or %**	**2015-16 Estimate £m or %**	**2016-17 Estimate £m or %**	**2017-18 Estimate £m or %**
Upper Limit for Fixed Interest Rate Exposure	-£0.030	-£0.030	-£0.030	-£0.030	-£0.030	-£0.030
Upper Limit for Variable Interest Rate Exposure	-£0.012	-£0.012	-£0.012	-£0.012	-£0.012	-£0.012

The limits above provide the necessary flexibility within which decisions are made for drawing down new loans on a fixed or variable rate basis; the decisions are ultimately determined by expectations of anticipated interest rate movements as set out in the Council’s treasury management strategy.

As the Council’s investments are substantially in excess of its borrowing, these calculations have resulted in a negative figure.

Maturity Structure of Fixed Rate borrowing:

This indicator highlights the existence of any large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates and is designed to protect against excessive exposures to interest rate changes in any one period, in particular in the course of the next ten years.

It is calculated as the amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate. The maturity of borrowing is determined by reference to the earliest date on which the lender can require payment.

Maturity structure of fixed rate borrowing	**Existing level (or Benchmark level) at 31/03/14 %**	**Lower Limit for 2014/15 %**	**Upper Limit for 2015/16 %**
Less than twelve months	0%	0%	100%
12 months – 10 years	0%	0%	100%
10 years plus	0%	0%	100%

Credit Risk:
The Council considers security, liquidity and yield, in that order, when making investment decisions with Security the most important. With the uncertainty in market, the Council is seeking to place investments for a short term and is effectively forgoing return in order to protect capital.

Credit ratings remain an important element of assessing credit risk, but they are not a sole feature in the Council's assessment of counterparty credit risk.

The Council also considers alternative assessments of credit strength, and information on corporate developments of and market sentiment towards counterparties. The following key tools are used to assess credit risk:

- Published credit ratings of the financial institution
- Sovereign support mechanisms;
- Credit default swaps (where quoted);
- Share prices (where available);
- Economic fundamentals, such as a country's net debt as a percentage of its GDP);
- Corporate developments, news, articles, markets sentiment and momentum;
- Subjective overlay.

The only indicators with prescriptive values remain to be credit ratings. Other indicators of creditworthiness are considered in relative rather than absolute terms.

Upper Limit for total principal sums invested over 364 days:
The purpose of this limit is to contain exposure to the possibility of loss that may arise as a result of the Council having to seek early repayment of the sums invested.

	2014-15 Approved £m	**2014-15 Revised £m**	**2015-16 Estimate £m**	**2016-17 Estimate £m**	**2017-18 Estimate £m**
Upper Limit for total principal sums invested over 364 days	15.0	15.0	15.0	15.0	15.0