Gedling Borough Council

Report to Cabinet

Subject: Annual Treasury Activity Report 2015/16

Date: 16 June 2016

Author: Financial Services Manager (Chief Financial Officer)

Wards Affected

All

Purpose

To inform members of the outturn in respect of the 2015/16 Prudential Code Indicators, and to advise members of the outturn on treasury activity, both as required by the Treasury Management Strategy.

Key Decision

This is not a key decision.

Background

1.1 The Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury review of its activities, and the actual prudential and treasury indicators for 2015/16. 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).

1.2 For 2015/16 the minimum reporting requirements were that the Full Council should receive the following reports:

- An annual treasury strategy in advance of the year (the TMSS). This was considered by Council on 3 March 2015.
- A mid-year treasury update report (members will note that, as in previous years and in accordance with best practice, quarterly monitoring reports for treasury activity have been provided, and that this exceeds the minimum requirements).
- An annual review following the end of the year describing the activity compared to the strategy (this report).

1.3 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 during the year, and highlights compliance with the Council's policies, previously approved by members.

1.4 The Council has complied with the requirement under the Code to give prior scrutiny to all the above treasury management reports by submitting them to Cabinet before they are reported to Full Council.

1.5 Member training on treasury management issues is undertaken by the Chief Financial Officer as it is needed in order to support members' scrutiny role. In addition, the Council's treasury advisers, Capita Asset Services (CAS) delivered a more detailed training session for members in February 2016.

Proposal

2.1 The economy and interest rates in 2015/16

2.1.1 Market expectations for the first increase in Bank Rate moved considerably during 2015/16, starting at Q3 of 2015 but soon moving back to Q1 of 2016. By the end of the year, market expectations had moved back significantly, to Q2 of 2018, due to concerns around China's slowing economic growth, the potential destabilisation of those emerging markets particularly exposed to the Chinese economic slowdown, the continuation of the collapse in oil prices during 2015 and continuing Eurozone growth uncertainties.

2.1.2 The concerns raised above caused sharp market volatility in equity prices during 2015/16 and Bank Rate therefore remained unchanged at 0.5% for the seventh successive year. Economic growth was disappointing, falling steadily from 2.9% in Q1 2015 to 2.1% in Q4.

2.1.3 The sharp volatility in equity markets was reflected by volatility in bond yields, however the overall trend from July 2015 was for bond 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 during 2015/16 was that several banks introduced negative interest rates as a measure to stimulate the creation of credit, and hence economic growth.

2.1.4 The European Central Bank (ECB) commenced a quantitative easing programme of purchasing Eurozone government and other bonds in March 2015, which put downward pressure on Eurozone bond yields. In December there was a further increase in this programme.

2.1.5 The US economy continued to grow as a result of resilient consumer demand. The first increase in the US central rate took place in December 2015, since when there has been a return to caution around the speed of further increases, due to concerns around the risk to world growth.

2.1.6 The UK elected a majority Conservative Government in May 2015, removing one potential uncertainty but introducing another due to the promise of a referendum on the UK remaining part of the EU. The government maintained its tight fiscal policy stance but the more recent downturn in expectations for economic growth has made it more difficult to return public sector net borrowing to a balanced annual position within the period of this parliament.

2.2 The overall treasury position 31 March 2016

The Council's debt and investment position is organised to ensure adequate liquidity for revenue and capital activities, security of investment, and to manage risks within all treasury management activities. At the beginning and end of 2015/16, the treasury position was as follows:

	1 April 2015 £000s	31 March 2016 £000s
Total external debt	9,812	7,812
Capital Financing Requirement (CFR)	11,850	11,327
Over/(under) borrowing to CFR	**(2,038)**	**(3,515)**
Total external debt	9,812	7,812
Total investments	(8,850)	(9,090)
Net debt/(investment)	**962**	**(1,278)**

2.3 The treasury strategy for 2015/16

The expectation for interest rates within the strategy for 2015/16 anticipated Bank Rate to be low, but rising gradually from Q1 of 2016. Medium and longer term fixed rates were then expected to rise gradually in 2016/17. Variable or short term rates were expected to be the cheaper form of borrowing over the period. Continued uncertainty in the aftermath of the 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 to postpone borrowing to avoid the cost of holding higher levels of investments, and to reduce counterparty risk.

2.4 The borrowing requirement

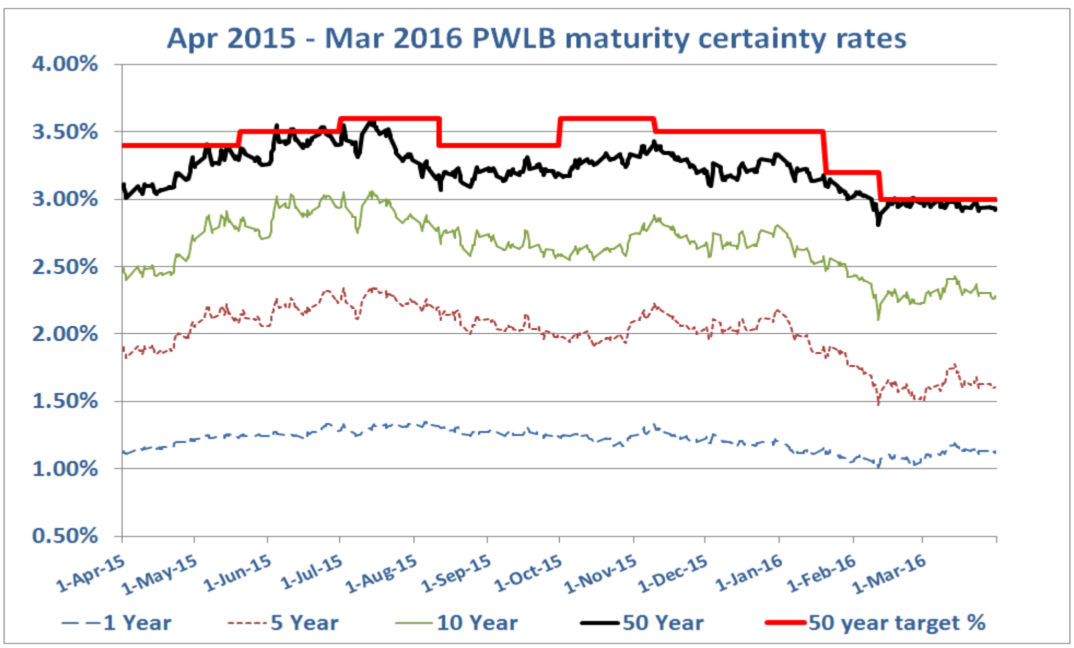
The Council's underlying need to borrow to finance its capital expenditure is termed the capital financing requirement (CFR).

	1 April 2015 (Actual) £000s	31 March 2016 (Orig. Est) £000s	31 March 2016 (Actual) £000s
Capital Financing Requirement	11,850	11,894	11,327

The variance is due to amendments to the capital programme during 2015/16, including slippage of schemes to 2016/17, and the early redemption of a small transferred debt balance with Nottinghamshire County Council which reduced the net MRP charge for the year.

2.5 Borrowing rates in 2015/16

The graph below, provided by the Council's treasury advisers, illustrates that PWLB certainty rates have fallen to historically low levels during the year.



2.6 The borrowing outturn for 2015/16

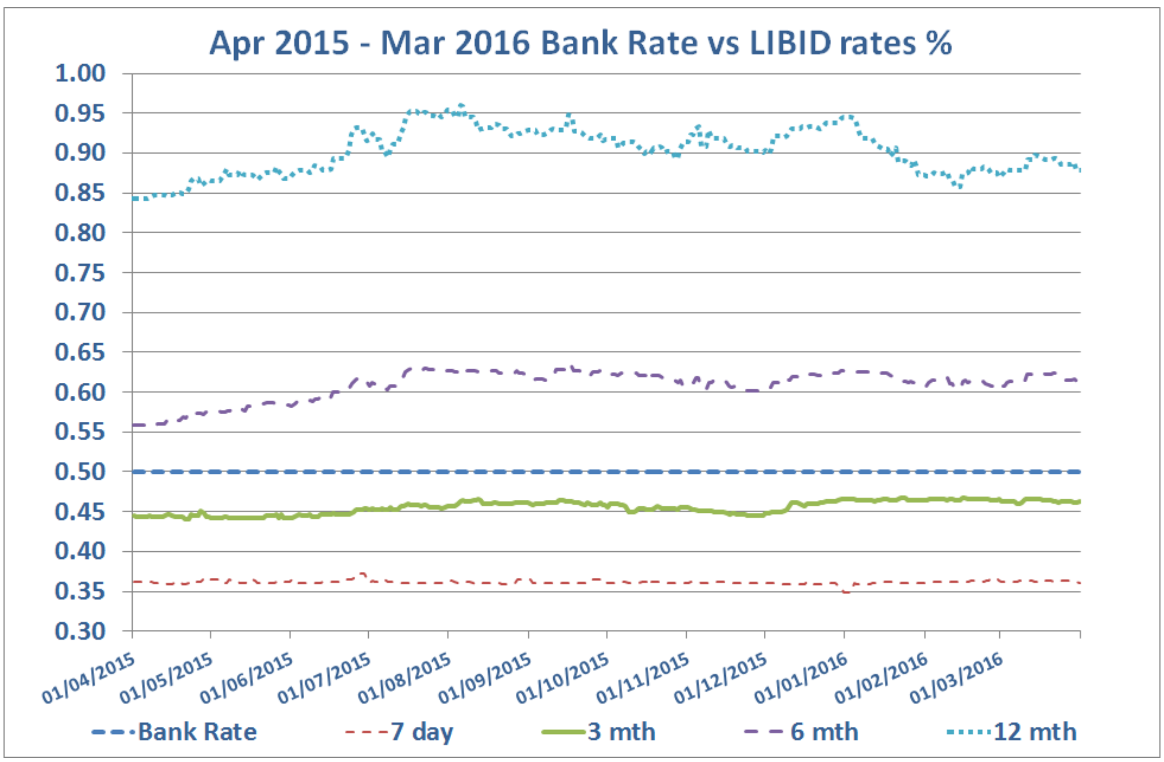
2.6.1 Two PWLB loans of £1m each were redeemed during 2015/16. These were not replaced, and no new long term debt was taken during the year.

2.6.2 There was no rescheduling of PWLB debt undertaken during the year, as the average 1% differential between PWLB new borrowing rates and premature repayment rates made such action unviable.

2.6.3 Four temporary loans for cashflow purposes were arranged during 2015/16, however the maximum duration of these was only six days, and the average rate paid was 0.32%.

2.7 Investment rates in 2015/16

Bank Rate remained at its historic low of 0.5% throughout the year and has now remained unchanged for seven years. Market expectations as to the timing of the start of monetary tightening started the year at Q3 of 2015 but then moved back to around Q2 of 2018 by the end of the year. Deposit rates remained depressed throughout the year, primarily due to the effects of the Funding for Lending Scheme and due to continuing weak expectations of when Bank Rate would start rising.



2.8 Investment outturn for 2015/16

2.8.1 The Council's investment policy is governed by CLG guidance and implemented by the annual investment strategy, which formed part of the TMSS approved on 3 March 2015. This policy sets out the approach for selecting investment counterparties. For 2015/16 the Chief Financial Officer adopted the Capita Asset Services (CAS) credit rating methodology, a sophisticated modelling approach utilising credit ratings from all three of the main rating agencies to give a suggested maximum duration for investments. Accordingly it does not give undue preponderance to one agency's ratings. The methodology subsequently applies an "overlay" to take account of positive and negative credit watches and/or credit outlook information, which may increase or decrease the suggested duration of investments. It then applies a second overlay based on the credit default swap spreads for institutions, the monitoring of which has been shown to give an early warning of likely changes in credit ratings. The methodology also incorporates sovereign ratings to ensure selection of counterparties from only the most creditworthy countries.

2.8.2 Whilst credit ratings advice is taken from the treasury advisers, the ultimate decision on what is prudent and manageable for the Council is taken by the Chief Financial Officer under the approved scheme of delegation.

2.8.3 The Council's investment priorities in 2015/16 remained the security of capital and good liquidity. Whilst the Council always seeks to obtain the optimum return (yield) on its investments, this is at all times commensurate with proper levels of security and liquidity. In the current economic climate it has remained appropriate either to keep investments short–term to cover cashflow needs, or to take advantage of fixed period up to one year with a small number of selected counterparties.

2.8.4 During 2015/16, significant use was made of a money market fund achieving around 0.44%. This fund is an AAA rated investment vehicle which allows the pooling of many billions of pounds worth of assets into a highly diversified fund, thus reducing risk.

2.8.5 Investment interest or £105,410 was generated in the year, representing an equated rate of 0.74%. This outperforms the benchmark average 7 day LIBID rate, which ended the year at 0.36%, and in cash terms represents additional income to the General Fund of £54,100. This was achieved as result of positive investment management. Performance in respect of the longer average 3 month LIBID rate, which ended the year at 0.46%, still represents additional income of £39,900.

2.8.6 Investment activity during the year conformed to the approved strategy and the Council had no liquidity difficulties.

2.8.7 The Treasury Activity Report for the year ended 31 March 2016 is attached at Appendix 1 in accordance with the TMSS. For reference, definitions of LIBOR and LIBID are given at Appendix 2.

2.9 Compliance with Prudential and treasury indicators

2.9.1 It is a statutory duty for the Council to determine and keep under review the affordable borrowing limit. The Council's approved Prudential and Treasury Indicators (affordability limits) are included in the Treasury Management Strategy Statement (TMSS) approved by Council on 3 March 2015.

2.9.2 During the financial year 2015/16 the Council has at all times operated within the treasury limits and Prudential Indicators set out in the council's TMSS, and in compliance with the Council's Treasury Management Practices. A summary of the outturn in respect of the 2015/16 Prudential and Treasury Indicators is shown at Appendix 3.

a) Prudential Indicators:

i) Capital Expenditure

Capital expenditure for 2015/16 totalled £1,951,070.

ii) Capital Financing Requirement (CFR)

The CFR represents the Council's underlying need to borrow and totalled £11,327,287 at 31 March 2016. This is lower than the approved indicator of £11,894,200 due mainly to amendments to the capital programme during the year, including slippage to 2016/17.

iii) Ratio of Financing Costs to Net Revenue Stream

The outturn of 9.55% represents a reduction from the approved indicator of 10.39%. This largely due to reductions in MRP as a result of slippage and savings on the capital programme in the previous year, 2014/15, but also to an increase in projected investment income due to positive investment management.

iv) Maximum gross debt

The Council must ensure that its gross debt does not, except in the short term, exceed the opening capital financing requirement, plus estimates of any additional CFR for 2015/16 and the following two financial years. This allows flexibility for early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes. Gross debt at 31 March 2016 was £7.812m which was well within the approved indicator.

Treasury Management Indicators:

These indicators are based on limits, beyond which activities should not pass without management action, and the Council has operated within these limits at all times during 2015/16. They include two key indicators of affordability and four key indicators of prudence.

Affordability

i) Operational boundary for external debt.
ii) Authorised limit for external debt.

Prudence

iii) Upper limit for fixed interest exposure – represented by the maximum permitted net outstanding principal sum borrowed at fixed rates. Please note that a negative indicator represents a position of net investment.

iv) Upper limit for variable interest rate exposure – represented by the maximum permitted net outstanding principal sum borrowed at variable rates. Please note that a negative indicator represents a position of net investment.

v) Maximum new principal sums to be invested during 2015/16 for periods in excess of 364 days - such investments are classified as a "non-specified". This indicator is subject to the overall limit for non-specified investments set in the TMSS.

vi) Upper limits for the maturity structure of borrowing - set to reduce the Council's exposure to large fixed rate sums falling due for refinancing.

2.10 Other Issues

2.10.2 No significant treasury matters arose during the year 2015/16.

Alternative Options

There are no alternative options, this report being a requirement of the Council's Treasury Management Strategy Statement (TMSS).

Financial Implications

No specific financial implications are attributable to this report.

Appendices

1. Annual Treasury Activity Report 2015/16.
2. Definitions of LIBOR and LIBID
3. Outturn Prudential and Treasury Indicators for 2015/16.

Background Papers

None identified.

Recommendation

That:

Members note the Annual Treasury Activity Report 2015/16, together with the appendices, and refer it to Council for approval.

Reasons for Recommendations

To comply with the requirements of the Council's Treasury Management Strategy Statement.

For more information, please contact:

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