ANNUAL TREASURY MANAGEMENT REVIEW 2015/16

Meeting	**Council – 13 October 2016**
Report Author	**Tim Willis, Director of Corporate Resources & Section 151 Officer**
Portfolio Holder	**Councillor John Townend, Portfolio Holder for Financial Services and Estates**
Status	**For Decision**
Classification:	**Unrestricted**
Key Decision	**No**
Reasons for Key *(if appropriate)*	**N/A**
Previously Considered by	**Governance and Audit Committee – 22 June 2016** **Cabinet – 28 July 2016**
Ward:	**N/A**

Executive Summary:

This report summarises treasury management activity and prudential/ treasury indicators for 2015/16.

Recommendation(s):

That Council:

- Notes the actual 2015/16 prudential and treasury indicators in this report.
- Approves the annual treasury management report for 2015/16.

CORPORATE IMPLICATIONS	
Financial and Value for Money	The financial implications are highlighted in this report.
Legal	Section 151 of the 1972 Local Government Act requires a suitably qualified named officer to keep control of the Council's finances. For this Council, this is the Director of Corporate Resources, Tim Willis, and this report is helping to carry out that function.
Corporate	Failure to undertake this process will impact on the Council's compliance with the Treasury Management Code of Practice.

Equalities Act 2010 & Public Sector Equality Duty	There are no equity and equalities implications arising directly from this report, but the Council needs to retain a strong focus and understanding on issues of diversity amongst the local community and ensure service delivery matches these. It is important to be aware of the Council's responsibility under the Public Sector Equality Duty (PSED) and show evidence that due consideration had been given to the equalities impact that may be brought upon communities by the decisions made by Council.

CORPORATE PRIORITIES (tick those relevant)✓	
A clean and welcoming Environment	
Promoting inward investment and job creation	
Supporting neighbourhoods	

CORPORATE VALUES (tick those relevant)✓	
Delivering value for money	✓
Supporting the Workforce	
Promoting open communications	

1.0 Introduction and Background

1.1 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 2015/16. This report meets the requirements of both the Chartered Institute of Public Finance & Accountancy (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 During 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 (Council 05/02/2015 and amended by Council 23/04/2015)
- a mid-year treasury update report (Council 25/02/2016)
- 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 and highlights compliance with the Council's policies previously approved by members.

1.4 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 Governance and Audit Committee before they were reported to the full Council. Member training on treasury management issues was undertaken during the year on 21/09/2015 in order to support members' scrutiny role. The Council's external treasury management advisor is Capita Asset Services (Capita).

1.5 The Council's 2015/16 accounts have not yet been audited and hence the figures in this report are subject to change.

2.0 Capita's Review of the Economy and Interest Rates (issued by Capita in April 2016)

2.1 Market expectations for the first increase in Bank Rate moved considerably during 2015/16, with expectations of an increase starting at quarter 3 2015 but soon moving back to quarter 1 2016. However, by the end of the year, market expectations of an increase had moved 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.

2.2 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.

2.3 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 bank 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.

2.4 The European Central Bank (ECB) commenced a full blown quantitative easing (QE) programme of purchases of Eurozone government and other bonds starting in March at €60bn per month. This put downward pressure on Eurozone bond yields. There was a further increase in this programme of QE in December 2015.

2.5 As for America, the economy has continued to grow healthily on the back of resilient consumer demand. The first increase in the central bank rate occurred in December 2015 since when there has been a return to caution as to the speed of further increases due to concerns around the risks to world growth.

2.6 The UK elected a majority Conservative Government in May 2015, who promised 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 the public sector net borrowing to a balanced annual position within the period of this parliament.

3.0 Overall Treasury Position as at 31 March 2016

3.1 At the beginning and the end of 2015/16 the Council's treasury (excluding borrowing by private finance initiatives (PFI) and finance leases) position was as follows:

	31 March 2015 Principal £000	Rate/ Return	Average Life yrs	31 March 2016 Principal £000	Rate/ Return	Average Life yrs
General Fund (GF) debt	9,790	3.18%	13.8	9,179	3.26%	13.8
Housing Revenue Account (HRA) debt	20,869	3.98%	10.1	20,041	4.03%	9.7
Total debt	**30,659**	**3.77%**	**11.3**	**29,220**	**3.78%**	**11.0**
GF CFR	22,390			27,067		
HRA CFR	20,874			20,241		
Total CFR	**43,264**			**47,308**		
Over / (under) borrowing	**(12,605)**			**(18,088)**		
Total investments	**29,435**	**0.53%**		**28,612**	**0.55%**	
Net debt	**1,224**			**608**		

4.0 The Strategy for 2015/16

4.1 The expectation for interest rates within the treasury management strategy for 2015/16 anticipated low but rising Bank Rate, (starting in quarter 2 of 2016), and gradual rises in medium and longer term fixed borrowing rates during 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 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.

4.2 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.

4.3 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.

4.4 ***Change in strategy during the year*** – the strategy adopted in the original Treasury Management Strategy Report for 2015/16 approved by the Council on 05/02/15 was revised by the Council on 23/04/15 to remove the Lowest Common Denominator assessment in the minimum credit ratings criteria (in accordance with advice from Capita).

5.0 The Borrowing Requirement and Debt

5.1 The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).

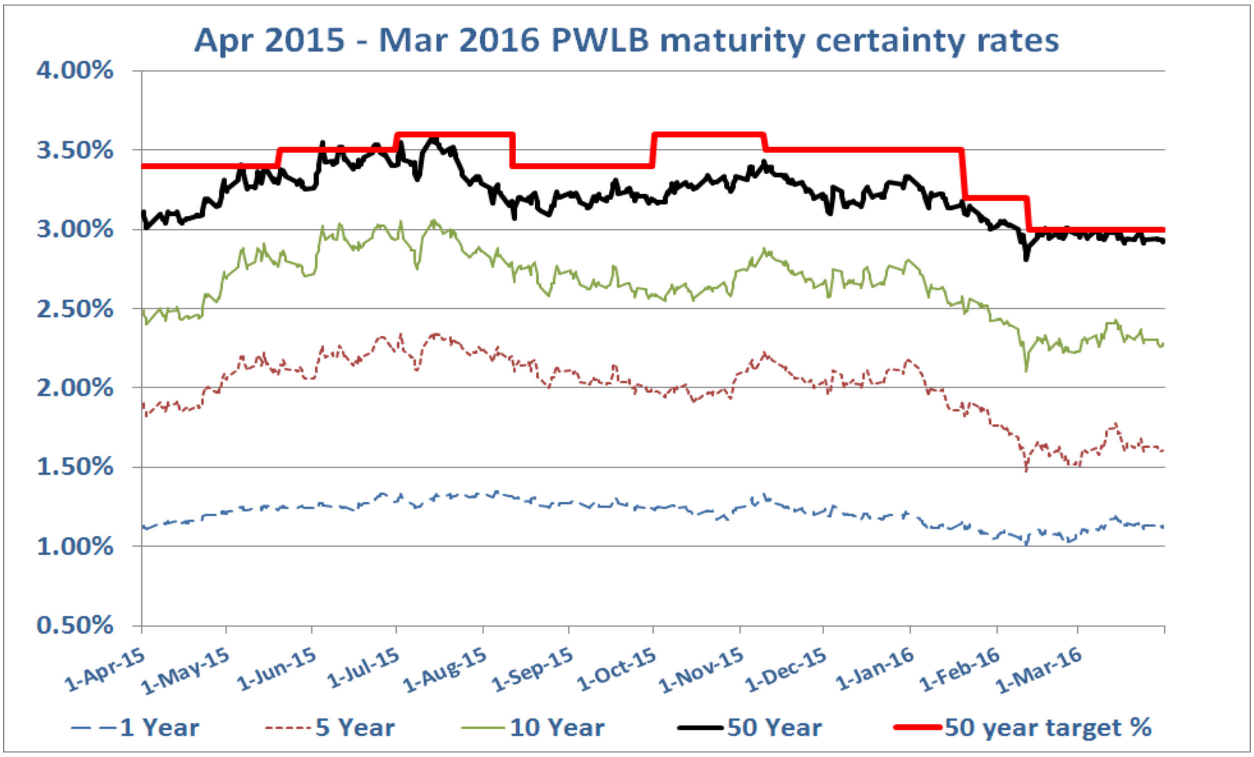
£000	31 March 2015 Actual	31 March 2016 Budget	31 March 2016 Actual
CFR GF	22,390	26,470	27,067
CFR HRA	20,874	23,607	20,241
Total CFR	43,264	50,077	47,308

The 2015/16 CFR HRA Budget included £3,561k for the New Build Programme, which is now due to start in 2016/17.

The 2015/16 CFR GF Actual reflects a Minimum Revenue Provision saving of £247k against Budget, with the remaining difference due to increased capital expenditure.

6.0 Borrowing Rates in 2015/16

6.1 **Public Works Loan Board (PWLB) certainty maturity borrowing rates -** the graph below shows how PWLB certainty rates have fallen to historically very low levels during the year.



7.0 Borrowing Outturn for 2015/16

7.1 **Borrowing** – Due to investment concerns, both counterparty risk and low investment returns, no borrowing was undertaken during the year.

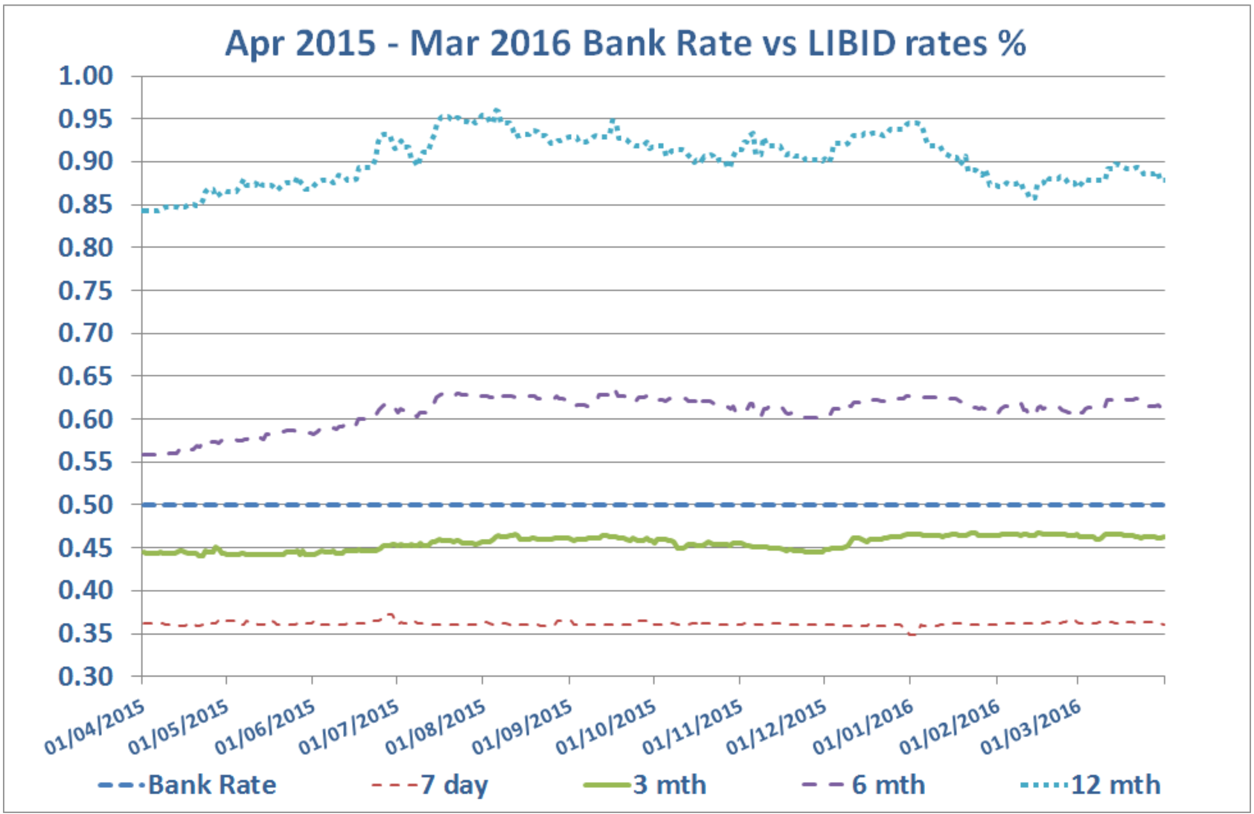
7.2 **Rescheduling** – No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

7.3 **Repayments** – The Council repaid £1,439k of maturing debt using investment balances.

Lender	Principal £000	Interest Rate	Repayment Date
PWLB	43	3.08%	23/04/15
PWLB	960	2.75%	03/05/15
PWLB	50	2.48%	27/05/15
PWLB	146	1.97%	27/05/15
PWLB	43	3.08%	23/10/15
PWLB	50	2.48%	27/11/15
PWLB	147	1.97%	27/11/15
Total £000	1,439		

7.4 **Summary of debt transactions** – The above repayment of the debt portfolio resulted in an increase in the average interest rate of 0.01%, representing an interest cost of £3k on the weighted average of the 2015/16 debt principal.

8.0 Investment Rates in 2015/16



8.1 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.

9.0 Investment Outturn for 2015/16

9.1 **Investment Policy** – the Council's investment policy is governed by Department for Communities and Local Government (CLG) guidance, which has been implemented in the annual investment strategy approved by the Council on 05/02/2015 (amended by Council 23/04/2015). 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).

9.2 The investment activity during the year conformed to the approved strategy, apart from the money limit with the Lloyds Banking Group (Lloyds) for the 11 day period from 15 May 2015 to 26 May 2015.

9.3 With effect from 15 May 2015 Capita changed its view on Lloyds, no longer regarding it as part nationalised. Given the credit rating of Lloyds, this meant that the Council's money limit with Lloyds reduced from £7m to £5m. The Council was able to reduce its deposits with Lloyds to under £5m on 26 May 2015, upon maturity of a £2m fixed term deposit with Lloyds.

9.4 The Council had no liquidity difficulties during the year.

9.5 **Investments held by the Council** - the Council maintained an average balance of £40,203k of internally managed funds. The internally managed funds earned an average rate of return of 0.55%. The comparable performance indicator is the average 7-day London Interbank Bid Rate (LIBID) rate, which was 0.36%. This compares with a budget assumption of £20,000k investment balances earning an average rate of 0.75%.

9.6 **Investments held by fund managers** – the Council does not use external fund managers.

10.0 Investment risk benchmarking

10.1 The following investment benchmarks were set in the Council's 2015/16 annual treasury strategy:

10.2 **Security** - The Council's maximum security risk benchmark for the current portfolio, when compared to historic default tables, is:

- 0.05% historic risk of default when compared to the whole portfolio.

10.3 **Liquidity –** in respect of this area the Council seeks to maintain:

- Bank overdraft - £0.5m
- Liquid short term deposits of at least £10m available with a week's notice.
- Weighted average life benchmark is expected to be 0.5 years, with a maximum of 1.0 year.

10.4 **Yield** - local measures of yield benchmarks are:

- Investments – internal returns above the 7 day LIBID rate

10.5 The Council kept to the above benchmarks during 2015/16.

11.0 Options

11.1 The recommended option (to ensure regulatory compliance as set out in section 1 of this report) is that Council

- Notes the actual 2015/16 prudential and treasury indicators in this report.
- Approves the annual treasury management report for 2015/16.

11.2 Alternatively, Council may decide not to do this.

12.0 Disclaimer

12.1 This report is a technical document focussing on public sector investments and borrowings and, as such, readers should not use the information contained within the report to inform personal investment or borrowing decisions. Neither Thanet District Council nor any of its officers or employees makes any representation or warranty, express or implied, as to the accuracy or completeness of the information contained herein (such information being subject to change without notice) and shall not be in any way responsible or liable for the contents hereof and no reliance should be placed on the accuracy, fairness or completeness of the information contained in this document. Any opinions, forecasts or estimates herein constitute a judgement and there can be no assurance that they will be consistent with future results or events. No person accepts any liability whatsoever for any loss howsoever arising from any use of this document or its contents or otherwise in connection therewith.

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Annex List

Annex 1	Prudential and Treasury Indicators

Corporate Consultation Undertaken

Finance	Tim Willis, Director of Corporate Resources
Legal	Tim Howes, Director of Corporate Governance & Monitoring Officer
Communications	Hannah Thorpe, Head of Communications