Cabinet
12 May 2016 **Agenda item 11**

Annual Treasury Report 2015/16

Cabinet Member: Councillor Peter Hare-Scott
Responsible Officer: Head of Finance and Section 151 Officer: Andrew Jarrett

Reason for the report: To inform Members of the Council's treasury management performance in 2015/16.

Matters for consideration: That the treasury management performance for 2015/16 be noted.

Relationship to the Corporate Plan: Maximising our return from all associated treasury activities, whilst minimising any credit default risk, enabling the Council to support current levels of spending in accordance with our Medium Term Financial Plan.

Financial implications: Investment protection reduced the available interest return during 2015/16.

Legal implications: Compliance with the CIPFA Code is a statutory duty.

Risk assessment: The Section 151 Officer is responsible for the administration of the financial affairs of the Council. Implementing this strategy and the CIPFA Code of Practice on Treasury Management manages the risk associated with the Council's treasury management activity.

1.0 Introduction

1.1 The Chartered Institute of Public Finance and Accountancy's Code of Practice on Treasury Management was amended in November 2009 and the Council fully complies with its requirements.

1.2 The primary requirements of the Code are as follows:-

- Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

- Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.

- Receipt by the Council of an annual strategy report for the year ahead and an annual review report of the previous year.

- Delegation by the Council of responsibilties for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

1.3 Treasury management in this context is defined as:

"The management of the local authority's 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 these risks."

1.4 The annual treasury report covers:

- the Council's treasury position for 2015/16
- performance measurement
- the strategy for 2015/16
- the economy in 2015/16
- borrowing and investment rates in 2015/16
- the borrowing outturn for 2015/16
- compliance with treasury limits and Prudential Indicators
- investment outturn for 2015/16

2.0 2015/16 Treasury Position

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

Investments	Principal held at 31 March 2015	Rate/ Return for 2014/15	Principal held at 31 March 2016	Rate/ Return for 2015/16
	£m	%	£m	%
Externally Placed	10.5	0.65	15.0	0.74
Deposit Account and cash balances	4.734	0.50	4.844	0.5
Total Investments	15.235		19.844 (1)	

Note (1) – A breakdown of the Total Investments is held at **Appendix A**.

2.2 In order to inform Members as to how the Council was able to hold £22.34m in cash, deposits, and investments as at the 31 March 2016 the following reconciliation is required:

Approximate Balances at 31 March 2016	**£m**
HRA	2.00
HRA Earmarked Reserves	8.80
General Fund	1.96
General Fund Earmarked Reserves (incl s106 monies and New Homes Bonus)	8.40
Capital Receipts Reserve	1.40
Total	**22.56**

2.3 The Council has working capital requirements and some monies are inevitably tied up in debtors, creditors and stock, in addition to the £19.8m of cash deposits. It should also be remembered that there is the issue of timing, where we collect some monies like council tax and business rates and hold this money temporarily prior to having to pay out precepts to Devon County Council, Devon and Cornwall Police and Devon and Somerset Fire Service.

3.0 Performance Measurement

3.1 One of the key changes in the revision of the Code in 2009 was the formal introduction of performance management relating to investments, debt and capital financing activities.

3.2 The use of benchmarks for local authorities such as Mid Devon, with relatively small cash balances, is considered difficult as we are only able to place funds for short periods, however we do review our performance against the 7 day London Interbank Bid Rate (LIBID), which, as at 31//3/16 was 0.36%.

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 1 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.

5.0 The Economy and Interest Rates

5.1 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.

5.2 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.

5.3 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. 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.

5.4 The ECB commenced a full blown quantitative easing 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.

5.5 As for America, the economy has continued to grow healthily on the back of resilient consumer demand. The first increase in the central 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.

5.6 The UK elected a majority Conservative Government in May 2015, removing one potential concern 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 the public sector net borrowing to a balanced annual position within the period of this parliament. The original market expectation at the beginning of 2015/16 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.

6.0 Borrowing and Investment Rates in 2015/16

6.1 **Investment Rates:** 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.

6.2 **Borrowing Rates**: PWLB borrowing rates - certainty rates have fallen to historically very low levels during the year.

7.0 Borrowing Outturn for 2015/16

7.1 Details of the loans outstanding at 31 March 2016 are shown below:

Public Works Loan Board	**Purpose**	**Final Payment**	**Interest rate %**	Principal held at 31 March 2015	Principal held at 31 March 2016
Ref Number				**£000**	**£000**
500248	HRA Self-Financing	28/3/37	2.94	42,622	41,219
502059	Gym Equip and Refuse Vehicle	28/3/18	1.32	261	175
502905	Scarab Street Sweeper	11/3/21	2.18	88	74
503319	Baler	25/03/24	2.68	148	133
503849	Market Walk/ Fore St	27/03/40	2.61	4,173	4,053
			Total	**47,292**	**45,654**

7.2 We also have a number of finance leases outstanding at year end (£570k in 15/16 and £681k in 14/15). The total interest paid on both PWLB loans and finance leases during 2015/16 was £1,392k, (2014/15 1,317k).

7.3 In addition to the external borrowing outlined in 7.1, the HRA borrowed £2.2m from the General Fund to finance the building of 22 new council houses at Wells Park, Crediton with £56k on interest accounted for between the two entities.

8.0 Compliance with Treasury Limits and Prudential indicators

8.1 During the financial year the Council operated within the Treasury limits and Prudential Indicators set out in the Council's Treasury Policy Statement and Annual Treasury Management Strategy statement. The outturn for the Prudential Indicators is shown in **Appendix B**.

9.0 Investment Outturn for 2015/16

9.1 **Internally managed investments** – The Council manages its investments in-house and invests with the institutions listed in the Council's approved lending list.

9.2 **Investment strategy** – Any fixed term investments in the market place (except Debt Management Office [DMO]) are restricted to a maximum term of 1 year, with the maximum counterparty limit of £5m. The Council's substantial commitments (particularly the monthly precepts to the County Council and the Police and Fire Authorities) constrain the term of investments.

9.3 **Investment outturn**

The final interest for the financial year can be summarised as follows:

Interest Paid and Received:

	Budget £k	Actual £k	Variance £k
Interest Paid:			
HRA	1,255	1,244	(11)
General Fund	68	147	79
HRA to General Fund	69	56	(13)
Interest Paid Total	**1,392**	**1,447**	**55**
Interest Received:			
General Fund	(65)	(118)	(53)
HRA	(40)	(42)	(2)
HRA-GF loan	(69)	(56)	13
Interest Received Total	**(174)**	**(216)**	**(42)**

10.0 CCLA Property Investment Fund

10.1 At the Cabinet on 30 July 2015 it was agreed that the Council's investment strategy could be adjusted to include deposits with the CCLA (Churches, Charities and Local Authorities) commercial property fund, up to a value of £2.5m. As a result of this, an investment of £2.5m commenced from 1 September 2015, so effectively the investment was held for seven months. During this period we received a total of £66k in dividends.

10.2 The investment was made with a view to a long term commitment and In common with most unit trusts and OEICS (Open ended investment companies) there is a bid/offer spread in respect of management charges. i.e. an initial investment of £100 is commonly worth £95 on day one, reflecting a 5% management charge. Our investment has started to recover this initial charge and at 31 March 2016 was valued at £2.4m.

11.0 Heritable Bank

11.1 During the year we received a further £44k from the Administrators. This means that we have now recovered 98.4% of our initial investment with only £18k of the principal remaining outstanding. There is also the prospect of potentially receiving a final dividend at some point in the future, although this is not by any means guaranteed and would be bonus if received.

12.0 Further Updates and Review

12.1 A report on treasury performance for the first 6 months of 2016/17 will be made to the Cabinet in October/November 2016 to enable Members to review the on-going Treasury Strategy and to provide an update on any other market/financial issues affecting the Council.

12.2 In accordance with recommendations agreed previously, any urgent issues relating to Treasury Management will be immediately referred to the Cabinet member for Finance.

Contact for any more information: Andrew Jarrett (01884 234242 – ajarrett@middevon.gov.uk) / JP Mclachlan– jpmclachlan@middevon.gov.uk)

Background Papers: Sector's Annual Treasury Management Report

Circulation of the Report: Management Team, Cllr Peter Hare-Scott