Annual Treasury Management Review 2015/16

Purpose

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 CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

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 12/02/2015)
- a mid-year (minimum) treasury update report (Council 14/12/2015)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

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 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 Treasury Management Panel before they were reported to the full Council.

Executive Summary

During 2015/16, 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	2014/15 Actual £000	2015/16 Budget £000	2015/16 Actual £000
Capital expenditure			
• **General Fund**	4,333	24,882	17,897
• **HRA**	6,974	5,458	6,949
• **TOTAL**	**11,307**	**30,340**	**24,846**
Capital Financing Requirement:			
• **General Fund**	28,821	41,398	40,666
• **HRA**	44,750	44,750	44,750
• **TOTAL**	**73,571**	**86,148**	**85,416**
Gross borrowing	**71,516**	**75,663**	**80,795**
External debt	**58,926**	**65,360**	**65,360**

Prudential and treasury indicators	2014/15 Actual £000	2015/16 Budget £000	2015/16 Actual £000
Investments • Longer than 1 year • Under 1 year • Total	 645 23,916 **24,561**	 575 16,885 **17,460**	 505 19,960 **20,465**
Net Borrowing	**46,955**	**58,203**	**60,330**

Other prudential and treasury indicators are to be found in Appendix 1 of this report. The Section 151 Officer (S151) also confirms that statutory borrowing limit (the authorised limit) was not breached at any time.

The financial year 2015/16 continued the challenging investment environment of previous years, namely low investment returns.

Recommendations

The Council is recommended to:

1. Approve the actual 2015/16 prudential and treasury indicators in this report
2. Note the annual treasury management report for 2015/16

Introduction and Background

This report summarises the following:-

- Capital activity during the year;
- Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement);
- The actual prudential and treasury indicators;
- Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances;
- Summary of interest rate movements in the year;
- Detailed investment activity.

1. The Council's Capital Expenditure and Financing 2015/16

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

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

£m General Fund/HRA	2014/15 Actual £000	2015/16 Budget £000	2015/16 Actual £000
Capital expenditure			
Financed in year	11,307	30,340	24,846
Unfinanced capital expenditure	**0**	**0**	**0**

2. The Council's Overall Borrowing Need

The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's indebtedness. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represents the 2015/16 unfinanced capital expenditure (see above table), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements.

Borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit.

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2016/17) plus the estimates of any additional capital financing requirement for the current (2015/16) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allows the Council some flexibility to either borrow in advance of its immediate capital needs in 2015/16 or reduce its investments. The table below highlights the Council's gross borrowing position against the CFR.

	31 March 2015 Actual	31 March 2016 Budget	31 March 2016 Actual
Gross borrowing position	£71.516m	£75.663m	£80.795m
CFR	£72.594m	£73.871m	£85.416m

The authorised limit - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level. The table below demonstrates that during 2015/16 the Council has maintained gross borrowing within its authorised limit.

The operational boundary – the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary is acceptable subject to the authorised limit not being breached.

Actual financing costs as a proportion of net revenue stream - this indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

	2015/16
Authorised limit	£116m
Operational boundary	£106.6m
Average gross borrowing position	£64.9m
Financing costs as a proportion of net revenue stream	5.61%

3. Treasury Position as at 31 March 2016

The Council's debt and investment position is organised by the treasury management service 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 through member reporting detailed in the summary. At the beginning and the end of 2015/16 the Council's treasury position was as follows:

TABLE 1	31 March 2015 Principal	Rate/Return	31 March 2016 Principal	Rate/Return
Fixed rate funding:				
-PWLB	£43.03m	3.78%	£49.46m	3.66%
-Market	£15.90m	4.00%	£15.90m	4.00%
-Temporary	-	-	-	-
Total debt	£58.93m	3.84%	£65.36m	3.74%
CFR	£73.87m		£85.42m	
Over / (under) borrowing	(£14.94m)		(£20.06m)	
Investments:				
- in house	£20.80m	0.62%	£20.47m	0.65%

4. The Strategy for 2015/16

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.

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.

5. The Economy and Interest Rates

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.

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.

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.

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.

6. Borrowing Outturn for 2015/16

For 2015/16 the Council's actual debt management costs (borrowing) were £2,464,176 compared to a revised budget of £2,169,000, an over spend of £295,176. The reason for this overspend is due to the accounting adjustment made for the PWLB loans taken on behalf of third parties (i.e. CBH, Airport, Everyman), with the interest repaid now coming under 'investment interest'. This will show a surplus in the investment outturn to balance off the overspend here. The weighted average rate on all loans for 2015/16 was 3.71% (2014/15 3.83%) on an average loan balance of £64,908,095 for the financial year.

The HRA repaid the General Fund £1.685m interest for the use of debt balances it holds.

Loans were drawn down in 2015/16 from the PWLB for £2.2m to fund capital expenditure for the St. Paul's Phase 2 Development project on behalf of Cheltenham Borough Homes. This loan was taken on an annuity basis in which Cheltenham Borough Homes are repaying back in full to the Council based on the loan term taken (30 years) with the PWLB, ensuring the GF is cost neutral. Another three PWLB loans totalling £4.750m were taken out between July and August 2015 to part fund the purchase of new offices, Delta Place.

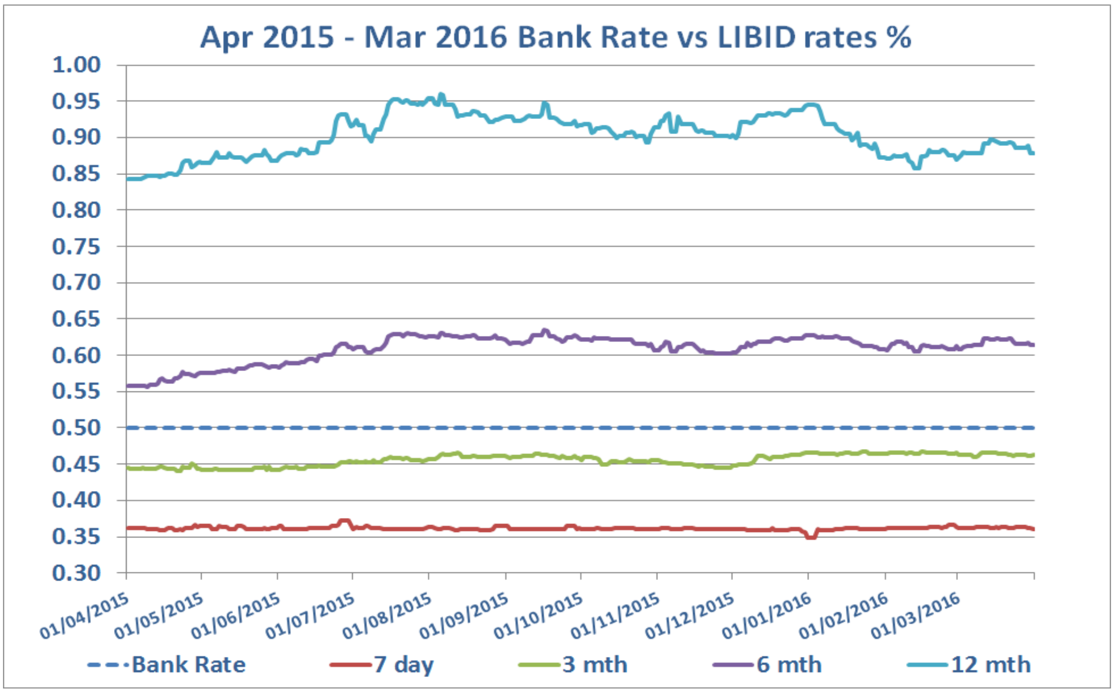
The loans drawn were:

Lender	Principal	Type	Interest Rate	Maturity
PWLB	£2.2m	Fixed interest rate	3.08%	30 years
PWLB	£1.75m	Fixed interest rate	3.07%	20 years
PWLB	£1.5m	Fixed interest rate	2.80%	15 years
PWLB	£1.5m	Fixed interest rate	2.16%	10 years

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. Investment Rates in 2015/16

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.



8. Investment Outturn for 2015/16

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 12th February 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.).

The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

Type of Investments	Balance on 01/04/2015 £	Average Weighed Balance Held in 2015/16 £	Interest Earned in 2015/16 £	% Rate Achieved in 2015/16 %	Balance on 31/03/2016 £
Fixed Term Deposits	12,000,000	15,187,218	115,333	0.76%	14,300,000
Call Accounts & MMF's	8,590,000	7,683,745	31,941	0.42%	5,660,000
Policy Investments	210,000	237,968	3,480	1.46%	140,000

The Council maintained an average balance of £23.109m of internally managed funds during 2015/16. The internally managed funds earned an average rate of return of 0.65%. The comparable performance indicator is the average 3 month LIBID rate which was 0.44% for the same period. The Council budgeted for £105,200 investment interest for 2015/16 but made an actual return of £485,946, a surplus of £380,746. Included in this figure was interest accrued on the Glitnir Escrow account which accounted for £30,544 towards the surplus and as mentioned in paragraph 6, the third parties PWLB interest repayments to the council are now included within the overall investment figure which accounts for £303,967 of the surplus.

Net loans and investments budget for 2015/16 was a cost of £2,063,800 but made an actual return of £1,978,230, a surplus of £85,570.

9. Icelandic Bank Defaults

The Council had £11m deposited with three Icelandic Banks when the banking system in Iceland collapsed in October 2008.

At the current time, the process of recovering assets is still ongoing with the administrators. In the case of Kaupthing, Singer and Friedlander Ltd, the administrators have made a number of dividend payments to date, with further payments and updates anticipated during 2016/17. To date 83.75p in the pound has been recovered. It is estimated that total dividends will be between 85p to 86.5p in the pound.

In regard to Glitnir the outstanding amount currently resides in an escrow account held in Iceland where it is earning interest at over 4%. Icelandic government controls are making it difficult for the Council to access these funds presently but it is reported that the Government controls could be relaxed sometime later on this year.

The table below shows the detailed repayments in respect of the specific Icelandic investments held in administration:

Icelandic Deposits Held	**Original Deposits**	**Amount Received to date**	**Amount Owed**
	£	**£**	**£**
Kaupthing Singer & Friedlander	2,000,000	1,675,000	325,000
Kaupthing Singer & Friedlander	1,000,000	837,500	162,500
Glitnir	3,000,000	2,427,600	572,400
Landsbanki	2,000,000	2,000,000	0
Landsbanki	2,000,000	2,000,000	0
Landsbanki	1,000,000	1,000,000	0
TOTAL	**11,000,000**	**9,940,100**	**1,059,900**

Appendix 1: Prudential and treasury indicators

1. PRUDENTIAL INDICATORS	2014/15	2015/16	2015/16
Extract from budget and rent setting report	actual	revised	actual
	£'000	£'000	£'000
Capital Expenditure			
Non - HRA	4,333	24,882	17,897
HRA	6,974	5,458	6,949
TOTAL	**11,307**	**30,340**	**24,846**
Ratio of financing costs to net revenue stream			
Non - HRA	2.90%	3.34%	2.77%
HRA	8.01%	7.78%	7.77%
Gross borrowing requirement			
brought forward 1 April	£68,454	£71,516	71,516
carried forward 31 March	£71,516	£75,663	80,795
in year borrowing requirement	£3,062	£4,147	£9,279
CFR			
Non – HRA	£28,821	£41,398	£40,666
HRA	£44,750	£44,750	£44,750
TOTAL	£73,571	£86,148	£85,416
Incremental impact of capital investment decisions	£	£	£
Increase in council tax (band D) per annum *	£nil	£nil	£nil
Increase in average housing rent per week **	£nil	£nil	£nil
* Council Tax Freeze for 2015/16			
** Decisions on annual rent increases are subject to rent restructuring guidelines set by Central Government. As a consequence rent levels will only rise by RPI Index plus 0.5% and this should cover all additional capital expenditure.			

2. TREASURY MANAGEMENT INDICATORS	2014/15	2015/16	2015/16
	actual	revised	actual
	£'000	£'000	£'000
Authorised Limit for external debt -			
borrowing	£109,000	£116,000	£116,000
other long term liabilities	£0	£0	£0
TOTAL	£109,000	£116,000	£116,000
Operational Boundary for external debt -			
borrowing	£101,000	£106,600	£106,600
other long term liabilities	£0	£0	£0
TOTAL	£101,000	£106,600	£106,600
Actual external debt	£58,926	£65,360	£65,360
Upper limit for fixed interest rate exposure			
Net principal re fixed rate borrowing / investments :-	0-100 %	0-100 %	0-100 %
Upper limit for variable rate exposure			
Net principal re variable rate borrowing / investments :-	0-100 %	0-100 %	0-100 %

Maturity structure of fixed rate borrowing during 2015/16	upper limit	lower limit
under 12 months	50%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%