Annual Treasury Management Review 2015/16

North Hertfordshire District Council
April 2016

Contents

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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 (Cabinet 15/12/2015)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

In addition, Cabinet has received quarterly treasury management update reports.

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 Finance, Audit and Risk Committee 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 Original £000	2015/16 Actual £000
Capital expenditure	4,532	11,337	3,524
Capital Financing Requirement:	-20,122	-15,992	-18,741
External debt	1,572	1,515	1,515
Investments			
• Longer than 1 year	7,750	0	7,750
• Under 1 year	27,970	34,000	30,275
• Total	35,720	34,000	38,025

Capital spend decreased during the year from an original budget of £11.34M to an actual of £3.52M. This was mainly due to the revision in the timetable for completion of schemes, and a net reduction on spend on other schemes.

Other prudential and treasury indicators are to be found in the main body of this report. The Strategic Director of Finance also confirms that no borrowing was only undertaken for a capital purpose and the statutory borrowing limit (the authorised limit) was not breached.

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 debt activity; and
- 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
- 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.

£m General Fund	2014/15 Actual	2015/16 Working Estimate	2015/16 Actual
Capital expenditure	4,532	**4,610**	3,524
Financed in year	1,367	2,418	2,156
Unfinanced capital expenditure	**3,165**	**2,192**	**1,368**

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. This may be sourced through borrowing from external bodies (such as the Government, through the Public Works Loan Board [PWLB] or the money markets), or utilising temporary cash resources within the Council.

Reducing the CFR – the Council's underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council has a negative CFR so is not required to make an annual revenue charge, called the Minimum Revenue Provision – MRP, to reduce the CFR. MRP is effectively a repayment of the borrowing need. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

The total CFR can also be reduced by:

- the application of additional capital financing resources (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

The Council's 2015/16 MRP Policy (as required by CLG Guidance) was approved as part of the Treasury Management Strategy Report for 2015/16 on 12/02/2015. Because the Council is in the unusual position of having a negative CFR there is no requirement currently to make an annual revenue charge (MRP).

The Council's CFR for the year is shown below, and represents a key prudential indicator. It includes leasing schemes on the balance sheet, which increase the Council's borrowing need. No borrowing is actually required against these schemes as a borrowing facility is included in the contract (if applicable).

CFR (£m): General Fund	31 March 2015 Actual	31 March 2016 Actual
Opening balance	-23,303	-20,122
Add unfinanced capital expenditure (as above)	3,165	1,368
Less MRP/VRP	0	0
Less finance lease repayments	16	**13**
Closing balance	-20,122	**-18.741**

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 (2015/16) plus the estimates of any additional capital financing requirement for the current (2016/17) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allowed the Council some flexibility to borrow in advance of its immediate capital needs in 2015/16. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

	31 March 2015 Actual	31 March 2016 Budget	31 March 2016 Actual
Gross borrowing position	£1.572m	£1.515m	£1.515m
CFR	-£20.122m	-£15.992m	-£18.741m

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	£8.0m
Maximum gross borrowing position	£1.57m
Operational boundary	£6.0m
Average gross borrowing position	£1.55m
Financing costs as a proportion of net revenue stream	-2.03%

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 both through member reporting detailed in the summary, and through officer activity detailed in the Council's Treasury Management Practices. At 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	£0.572m	8.87%	£0.515m	9.21%
-Market	£1.000m	10.125%	£1.000m	10.125%
Variable rate funding:				
-PWLB	£0m		£0m	
-Market	£0m		£0m	
Total debt	**£1.572m**	**8.54%**	**£1.515**	**8.55%**
CFR	**-£20.2m**		**-£18.8m**	
Over / (under) borrowing	**£21.77m**		**£20.315m**	
Investments:				
- in house	£2.72m	0.4%	£9.525m	0.62%
- Cash Managers	£33.00m	1.29%	£28.5m	1.25%
Total investments	**£35.72m**	**1.24%**	**£38.025m**	**1.22%**

The maturity structure of the debt portfolio was as follows:

	31 March 2015 actual	31 March 2016 actual
Under 12 months	£0.057m	£1.035m
12 months and within 24 months	£1.035m	£0.025m
24 months and within 5 years	£0.058m	£0.050m
5 years and within 10 years	£0.097m	£0.100m
10 years and above	£0.325m	£0.305m

The maturity structure of the investment portfolio was as follows:

	2014/15 Actual £000	31 March 2016 Actual £000
Investments		
Longer than 1 year	7,750	7,750
Under 1 year	27,970	30,275
Total	35,720	38,025

The exposure to fixed and variable rates was as follows:

	31 March 2015 Actual £000	2015/16 Original Limits	31 March 2016 Actual £000
Fixed rate (principal)	32,720Cr	70%-100% of Investments	36,000Cr
Variable rate (principal)	3,000Cr	0%-30% of Investments	2,025Cr

4. The Strategy for 2015/16

The strategy in 2015/16 was to continue only lending to UK banks and building societies. Only UK banks with a credit rating, for longer term deals, greater than “BBB” and F3 or above for short term credit ratings were on the Council’s lending list. (These are Fitch definitions of ratings). Not all building societies are credit rated but this did not preclude them from the lending list as lending to a building society was dependant on their asset size. Where a society did have a rating, this was considered at the time of the deal taking into account the amount of investment and the length of the deal. As well as imposing maximum limits with each counter party, the overall percentage of outstanding investments with each counterparty was assessed to ensure a reasonable spread of investments.

Change in strategy during the year – the strategy adopted in the original Treasury Management Strategy Report for 2015/16, approved by the Council on 12/02/2015, was not changed during the year.

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 the UK surged strongly during both 2013/14 and 2014/15 to make the UK the top performing advanced economy in 2014. However, 2015 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 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 materially. These rates continued at very low levels during 2015/16.

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 had announced in January 2015 that it would undertake 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. The anti-austerity government in Greece, elected in January 2015 eventually agreed to implement an acceptable programme of cuts to meet EU demands after causing major fears of a breakup of the Eurozone. Nevertheless, there are continuing concerns that a Greek exit has only been delayed.

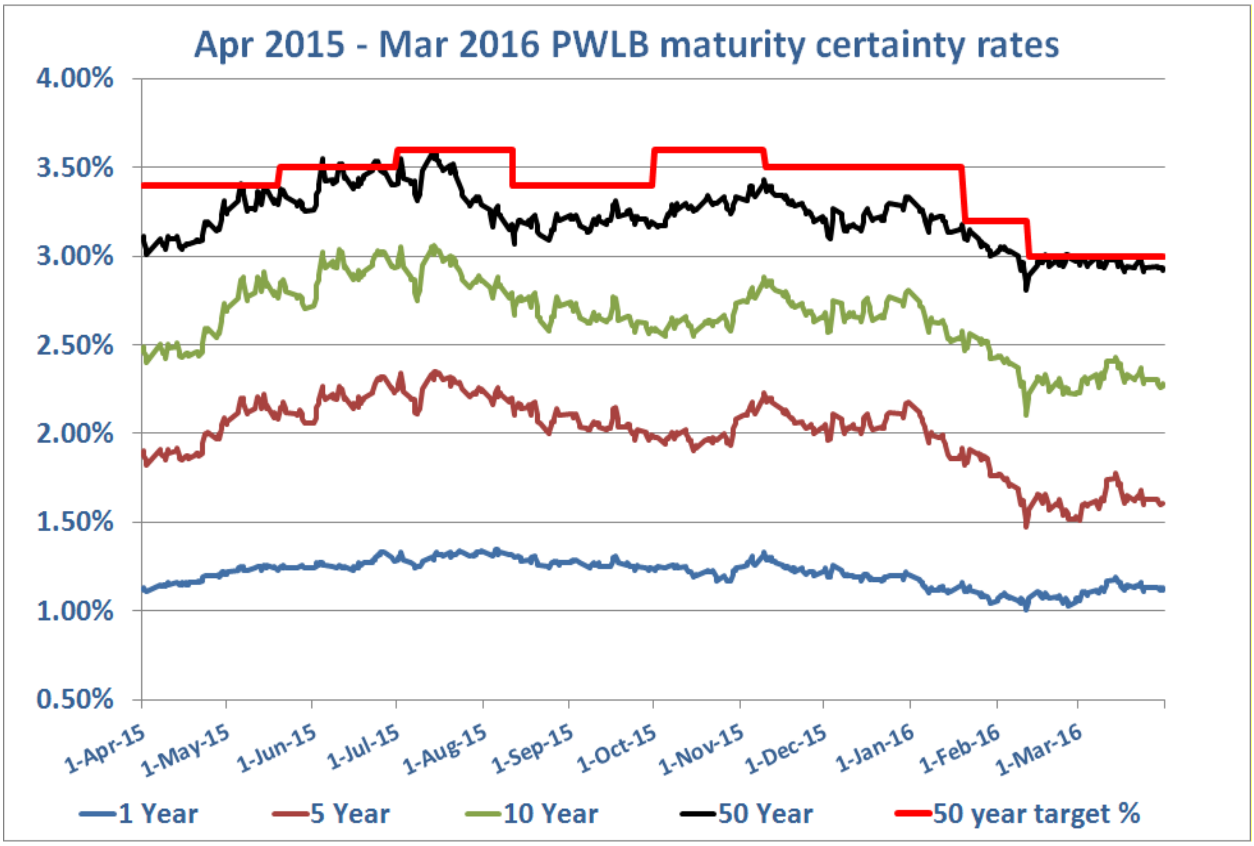
As for America, the economy has continued to grow healthily on the back of resilient consumer demand. The first increase in the central rate occurred in December 2015 since when there has been a return to caution as to the speed of further increases due to concerns around the risks to world growth.

On the international scene, concerns have increased about the slowing of the Chinese economy and also its potential vulnerability to both the bursting of a property bubble and major exposure of its banking system to bad debts. The Japanese economy has also suffered disappointing growth in this financial year despite a huge programme of quantitative easing, while two of the major emerging market economies, Russia and Brazil, are in recession. The situations in Ukraine, and in the Middle East with ISIS, have also contributed to volatility.

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 Rates in 2015/16

PWLB certainty maturity borrowing rates - the graph for PWLB rates below shows, for a selection of maturity periods, the average borrowing rates, the high and low points in rates, spreads and individual rates at the start and the end of the financial year.



7. Borrowing Outturn for 2015/16

Borrowing

No new loans were taken during the year.

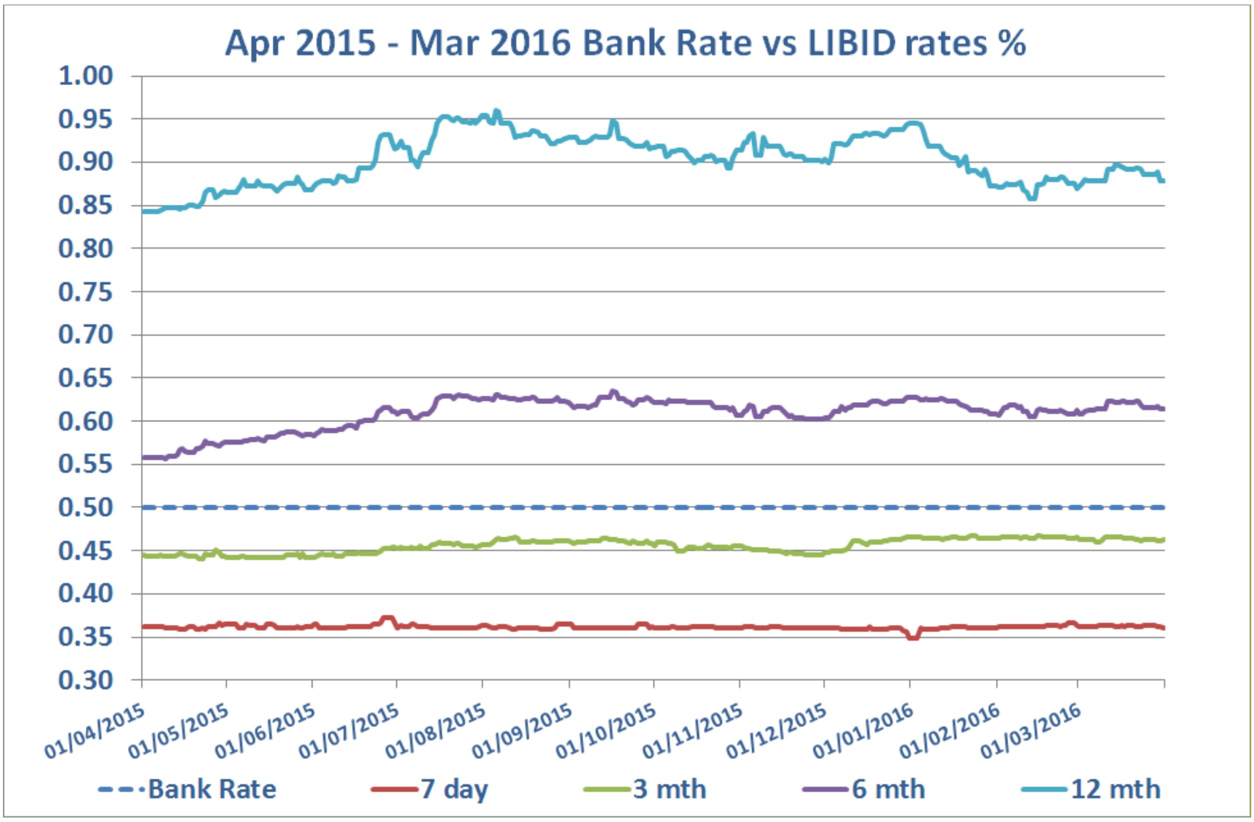
£57K of PWLB loans were repaid during the year

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.

8. 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.



9. Investment Outturn for 2015/16

Investment Policy – the Council's investment policy is governed by CLG investment guidance, which has been implemented in the annual investment strategy approved by the Council on 12/02/15. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the Fitch credit rating agency for banks and asset size for building society investments.

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

Investments placed by Cash Managers – the Council used two external cash managers to invest its cash balances. At the start of the year, Sterling had £13m of outstanding investments, Tradition £20m. Sterling ended their contract in December 2014 and as their investments matured, Tradition reinvested the principal. At year end, outstanding investments placed by Sterling were £1m and Tradition had £27.5m. In October £4.5m of Sterling investments were not reinvested long term when they matured. They were invested short term to fund Capital spend. The performance of the managers against the benchmark return was:

Cash Manager	Investments Placed	Interest	Return	Benchmark*
Sterling	£13M - £1M	£0.062M	1.28%	0. 54%
Tradition	£20M - £27.5M	£0.295M	1.13%	0.32%
Total	£33M - £28.5M	£0.357M	1.15%	

*Ave 3 Month LIBID Rate 0.456%
Ave 7 days notice Rate 0.32%

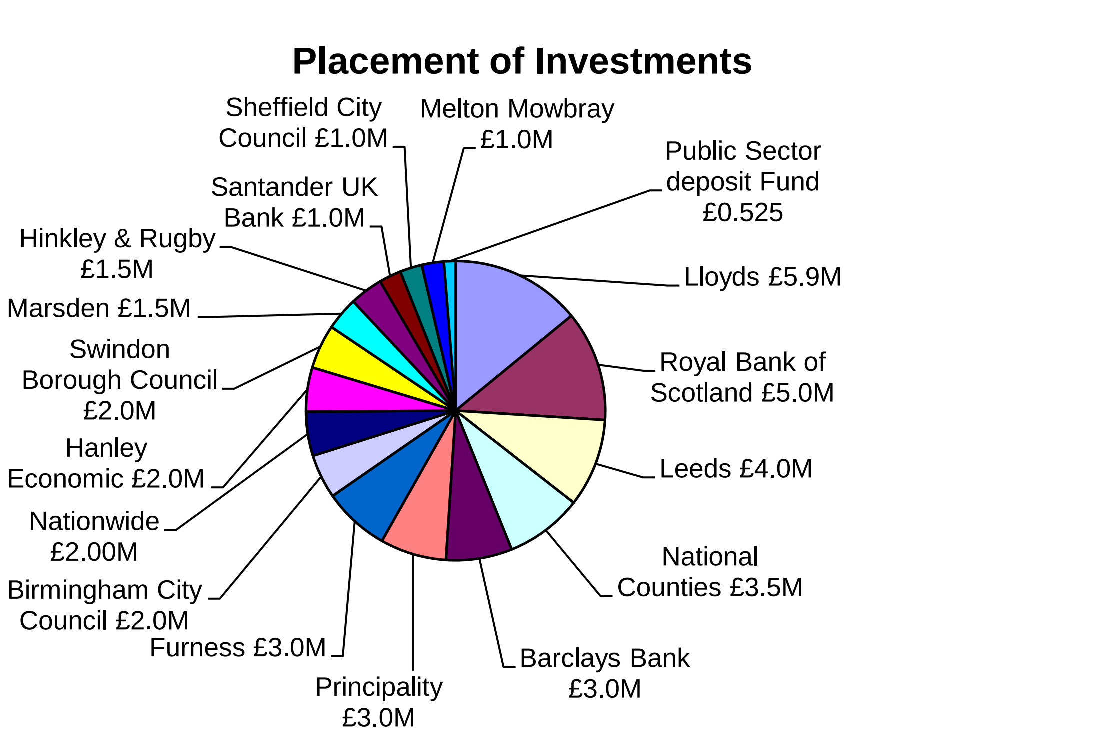
This compares with an original budget of £0.346M.

	Ave. Int. Rate Deals made in 1st Qtr %	Ave. Int. Rate Deals made in 2nd Qtr%	Ave. Int. Rate Deals made in 3rd Qtr %	Ave. Int. Rate Deals made in 4th Qtr %	Ave. Int. Rate Deals made in Year	Ave. Int. Rate for All Investments during Year %
NHDC	0.61	0.58	0.51	0.56	0.56	0.5
Sterling	n/a	n/a	n/a	n/a	n/a	1.28
Tradition	1.01	1.37	n/a	n/a	1.15	1.13

The table below summaries where investments were held at 31 March:

	Investments 31 March 2015	Investments 31 March 2016
Banks	£7.72m	£14.90m
Building Societies	£28.00m	£21.50m
Local Authorities	-	£5.00m
Money Market Funds	-	£0.525m
Total	£37.72m	£41.925m

The pie chart below shows the spread of investment balances as at 31 March 2016. This is a snapshot in time that demonstrates the diversification of investments.



The average daily balance of investments was £49.8m with balances varying between £38.8m and £62.9m.

£0.452m of interest was generated from investments during the year. This is slightly more than the estimated interest of £0.451m.

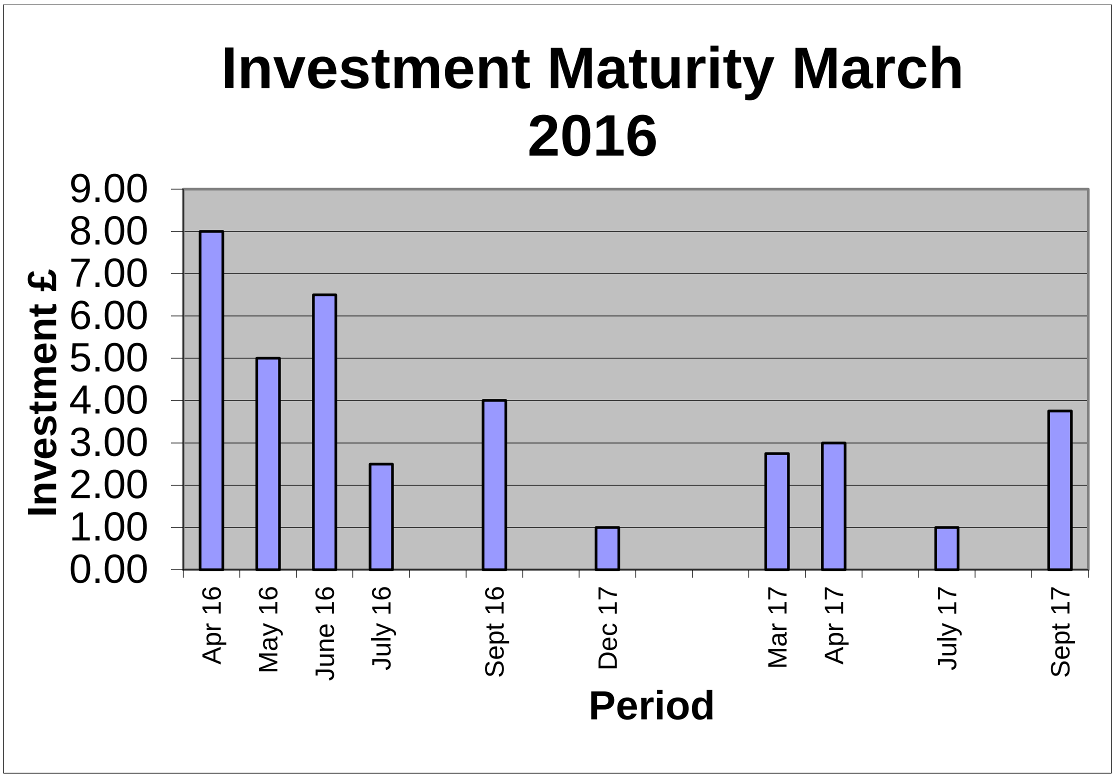
	Average Balance £M	Interest Accrued to 31 March £	Interest Received by 31 March £	Total Interest for the Year £	Average Rate of Return %
NHDC	18.9	7,350	87,910	95,260	0.5
Sterling	4.8	20,795	40,952	61,747	1.28
Tradition	26.1	215,804	78,949	294,753	1.13
Total	49.8	243,949	207,811	451,760	0.91

Investments held by the Council - the Council maintained an average balance of £18.9m of internally managed funds. The internally managed funds earned £95k of interest with an average rate of return of 0.50%.

Investments held by Sterling - Sterling maintained an average balance of £4.8M managed funds. This generated £62k interest and earned an average rate of return of 1.28%.

Investments held by Tradition – Tradition maintained an average balance of £26.1M managed funds. This generated £0.295M interest and earned an average rate of return of 1.13%.

The graph below shows the maturity profile of investments at 31st March 2016.


Investment Maturity March 2016
9.00
8.00
7.00
6.00
5.00
4.00
3.00
2.00
1.00
0.00
Investment £
Apr 16
May 16
June 16
July 16
Sept 16
Dec 17
Mar 17
Apr 17
July 17
Sept 17
Period