Treasury Management Annual Report 2014/15

1.1 Introduction

1.1.1 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 2014/15 **[Appendix 1]**. 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).

1.1.2 During 2014/15 the minimum reporting requirements were that the full Council should receive the following reports:

- an annual treasury strategy in advance of the year;
- a mid-year treasury update report; and
- an annual review following the end of the year describing the activity compared to the strategy (this report).

In addition, treasury management update reports have been presented to each meeting of the Audit Committee throughout the 2014/15 financial year. Treasury performance was also considered at the Finance, Innovation and Property Advisory Board through the regular Financial Planning and Control reports.

1.1.3 Changes in the regulatory environment place a much greater onus on Members for the review and scrutiny of treasury management policy and activities. This report is 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.

1.1.4 This Council also 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 Audit Committee before they were reported to full Council.

1.2 The Economy and Interest Rates

1.2.1 The original market expectation at the beginning of 2014/15 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 increases 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. During the second half of 2014 financial markets were caught out by a halving of the oil price and the collapse of the peg between the Swiss franc and the euro. Fears also increased considerably that the European Central Bank (ECB) was going to do too little too late to ward off the threat of deflation and recession in the Eurozone. By the end of 2014, it was clear that inflation in the UK was going to head towards zero in 2015 and possibly even turn negative. In turn, this made it clear that the Monetary Policy Committee (MPC) would have great difficulty in starting to raise Bank Rate in 2015 while inflation was around zero and so market expectations for the first increase receded to quarter 1 of 2016.

1.2.2 Gilt yields were on a falling trend for much of the last eight months of 2014/15 but were then pulled in different directions by increasing fears after the anti-austerity parties won power in Greece in January; developments since then have increased fears that Greece may exit the euro. While the direct effects of this would be manageable by the European Union (EU) and ECB, it is hard to quantify quite what the potential knock on effects would be on other countries in the Eurozone once the so called impossibility of a country leaving the Euro had been disproved. Another downward pressure on gilt yields was the announcement in January that the ECB would start a major programme of quantitative easing. On the other hand, strong growth in the US caused an increase in confidence that the US was well on the way to making a full recovery from the financial crash and would be the first country to start increasing its central rate, probably by the end of 2015. The UK is expected to follow due to strong growth in 2013 and 2014 and good prospects for a continuation into 2015 and beyond.

1.3 Treasury Position at 31 March 2015

1.3.1 At the beginning and the end of 2014/15 the Council's debt and investment position was as follows:

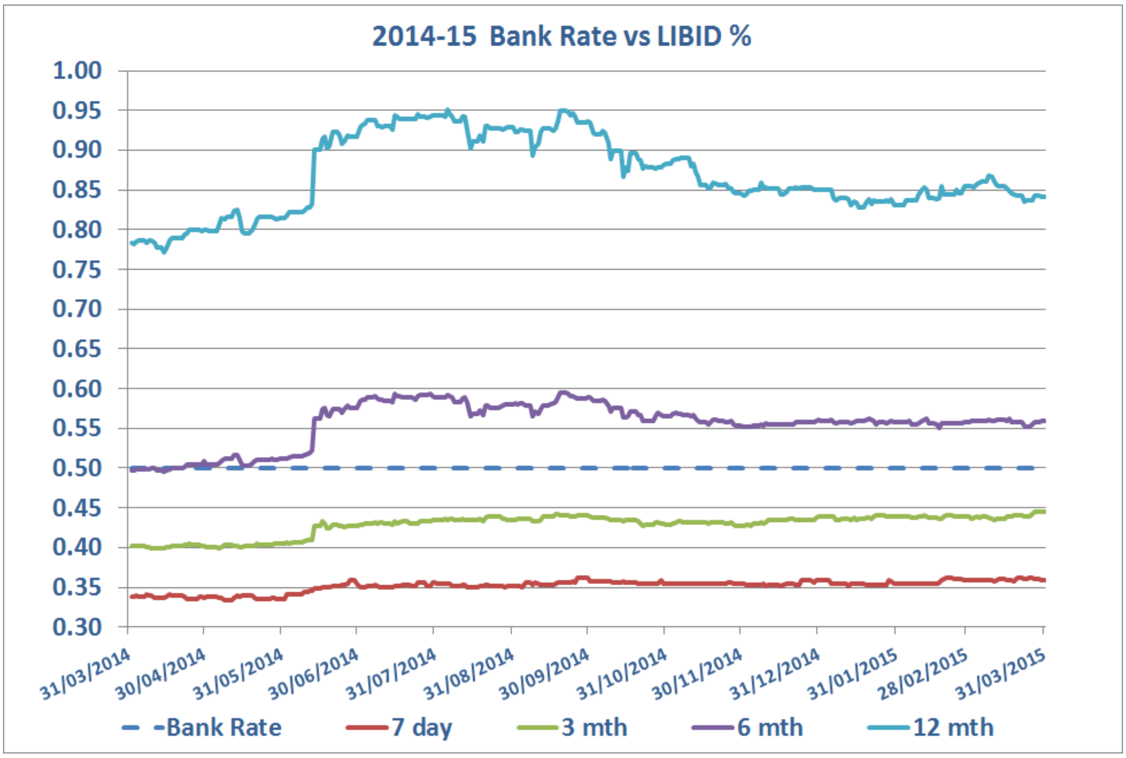
	31 March 2014 £m	Rate / Return %	Average duration Years	31 March 2015 £m	Rate / Return %	Average duration Years
Variable rate debt:						
Overdraft	0.00	-	-	0.00	-	-
Total debt	**0.00**	-	-	**0.00**	-	-
Fixed rate investments:						
In-house cash flow	2.00	1.10	0.03	2.00	0.95	0.04
In-house core fund	-	-	-	6.00	0.78	0.30
Externally managed core fund	0.64	0.35	0.17	-	-	-
Variable rate investments:						
In-house cash flow	3.55	0.74	0.01	4.02	0.64	0.00
In-house core fund	-	-	-	7.45	0.73	0.18
Externally managed core fund	12.76	0.62	0.81	-	-	-
Total Investments	**18.95**	**0.68**	**0.56**	**19.47**	**0.75**	**0.17**

1.4 The Strategy for 2014/15

1.4.1 The expectation for interest rates within the strategy for 2014/15 anticipated a low but rising Bank Rate starting in quarter 1 of 2015. 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.

1.5 Investment Rates in 2014/15

1.5.1 The Bank Rate remained at its historic low of 0.5% throughout the year and has now remained at that level for six years. Market expectations as to the start of monetary tightening started the year at quarter 1, 2015 but moved back to quarter 1, 2016 by the end of the financial year.



1.6 Investment Outturn for 2014/15

1.6.1 The Council's investment policy sets out the approach for choosing investment counterparties and is based on credit ratings provided by the three main credit rating agencies. This is supplemented by additional market information including credit rating outlooks and credit default swap data. The 2014/15 Annual Investment Strategy was approved by the Council in February 2014 and subjected to a mid-year review in October 2014. In undertaking the review, no changes were made to the Council's minimum counterparty credit requirement or counterparty exposure limits. However, because of the relatively poor performance delivered by the Council's external fund manager in the early part of the year the review did warn that investment returns for 2014/15 would be lower than originally anticipated. Investment returns were reduced as part of the budget setting process from £167,000 by £6,850 to £160,150.

1.6.2 **Cash Flow Investments**. The Council maintained an average balance of £10.9m of internally managed cash flow funds. These funds earned an average rate of return of 0.64%. The comparable performance indicator is the average 7-day LIBID rate which was 0.35%. The return achieved also compares with a revised budget assumption of £10.5m investment balances earning an average rate of 0.67%. The majority of cash flow funds are required to meet our regular payment obligations and as a consequence are invested overnight in bank deposit accounts and money market funds which allow next day access.

However, the opportunity to invest for longer durations and generate additional yield is taken when cash flow surpluses permit.

1.6.3 **Core Fund Investments**. Responsibility for the management of core funds was split between the Council's external fund manager, Investec Asset Management (April 2014 to July 2014) and in-house management (August 2014 onwards). Core funds earned an average rate of return of 0.70% on an average balance of £13.4m against a benchmark return of 0.35%. This compares with a revised budget assumption of an average investment balance of £13.1m at a return of 0.69%. Unlike cash flow, core fund balances are not required to meet our regular payment obligations and are available to invest for longer durations including durations exceeding one year. This added flexibility should allow core funds to generate a better return relative to cash flow investments. This expectation was realised in the final eight months of financial year following the transfer of core funds to in-house management.

1.6.4 Performance for the financial year as a whole is summarised in the table below:

	2014/15 Average Balance £m	Return %	2014/15 Interest Earned £	2014/15 Revised Estimate £	Variance Better (worse) £
In-house cash flow	10.9	0.64	70,000	70,000	-
Externally Managed core fund to 31 July	4.5	0.62	27,900	25,500	2,400
In-house managed core funds from 1 August	8.9	0.74	66,350	64,650	1,700
Total	24.3	0.68	164,250	160,150	4,100

1.6.5 The combined performance of the Authority's cash flow and core funds bettered the revised estimate by £4,100.

1.7 Compliance with the Annual Investment Strategy

1.7.1 Throughout the period April 2014 to March 2015 the requirements set out in the 2014/15 Annual Investment Strategy which aim to limit the Council's exposure to investment risks (minimum counterparty credit criteria; sovereign, counter-party and group exposure limits; type of investment instrument; and investment duration limits) have been complied with. No liquidity issues were experienced resulting in nil borrowing throughout 2014/15.

Financial Services
May 2015