Agenda Item No. 11

Governance, Audit and Scrutiny Committee 15 June 2014	Report by the Executive Director Service Support/S.151 Officer

TREASURY MANAGEMENT ANNUAL REPORT 2014/15

REPORT EXECUTIVE SUMMARY

This report provides Members with a review of the Authority's treasury management activity and Prudential Indicators for the year 2014/15.

The report shows full compliance with the Authority's Prudential Indicators for 2014/15.

RECOMMENDATIONS

1. That Members take assurance from the treasury management activities undertaken during 2014/15 and the Prudential Indicators as outlined in paragraphs 14 and 15 and detailed in Appendix 1.

BACKGROUND

2. Treasury Management, as defined by the Chartered Institute of Public Finance and Accountancy (CIFPA) Code of Practice 2009 is:

‘‘The management of the organisation’s investments and cash-flows, its banking and money market and capital market transactions, the effective control of the risks associated with those activities and the pursuit of the optimum performance consistent with those risks.’’

3. One of the main requirements of the CIPFA Code is that Members receive an annual report detailing treasury management activities within the year and compliance with the annual Treasury Management Policy.

4. This report provides Members with details of the Authority’s treasury management activities and Prudential Indicators for the 2014/15 financial year in line with the requirements of the Code.

ECONOMIC BACKDROP 2014/15

5. 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 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. 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 ECB was going to do too little too late to ward off the threat of deflation and recession in the Eurozone. In mid-October, financial markets had a major panic for about a week. 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 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 back to around quarter 3 of 2016.

6. 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 could be heading for an exit from the euro. While the direct effects of this would be manageable by the EU and ECB, it is very 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 EZ 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, purchasing EZ government and other debt in March. 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 would be closely following it due to strong growth over both 2013 and 2014 and good prospects for a continuation into 2015 and beyond. However, there was also an increase in concerns around political risk from the general election due in May 2015.

INVESTMENT ACTIVITY

7. The Authority's temporary investments totalled £19.1m as at 31 March 2015 with a further £550k in the Authority's Special Interest Bearing Account (SIBA). £3.4m of the Authority's investments relates to money held by the Authority on behalf of the East Coast and Hertfordshire Control Project.

Table 1 – Investment income earned 2014/15

Interest Earned 2014/15	Rate of return 2014/15	Benchmark return 2014/15*	Difference (+ favourable)
£115,264	0.461%	0.357%	0.104%

* Benchmark set as 7 day compounded LIBID

8. Interest earned during 2014/15 was £65k higher than originally budgeted for in respect of investment activity for the year, partly as a result of the interest accrued on the balance held on behalf of the East Coast and Hertfordshire Control Project which contributed £21k to the interest total. Pleasingly, the overall rate of return was marginally above the benchmark rate of return.

BORROWING

Short-Term Borrowing

9. The Authority seeks to minimise the use of short-term borrowing to fund temporary cash shortfalls. The Authority did not undertake any short-term borrowing during the course of the year.

Long-Term Borrowing

10. Long-term loans are taken out either to replace existing loans which have matured or to fund capital expenditure. Under the Prudential Regime there are no longer centrally imposed limits on borrowing, but individual Authorities are required to determine themselves what is a sustainable and affordable level of borrowing as an integral part of their Medium-Term Financial Planning processes.

11. The Authority's average level of borrowing was £17.2m for 2014/15, on which £768k of interest was payable. The Authority repaid £1.069k of PWLB debt upon maturity. Closing PWLB debt at 31 March 2015 was £16.6m.

PRUDENTIAL INDICATORS

12. Appendix 1 details the agreed Prudential Indicators for 2014/15 and the actual figures for 2014/15.

13. During the financial year the Authority operated wholly within the limits approved.

Capital Expenditure

14. The S.151 Officer considers the current capital programme to be affordable and sustainable with the revenue effects of capital investment built into the Medium-Term Financial Plan. Through the Medium-Term Financial Planning Process, the Authority has aligned its resources to key strategic priorities.

Treasury Management

15. Based on the Operational Boundary definition, external debt at 31 March 2015 was £5.9m below the agreed Operational Boundary for 2014/15 and the maturity structure for both borrowing and investments remain within the approved upper and lower limits. Subsequent borrowing or re-scheduling during 2015/16 will take in to account prevailing interest rates on offer from the Public Works Loans Board, the current maturity structure of loans, balanced with the need to reduce capital risk by keeping down cash-balances.

STRATEGIC PLAN COMPATIBILITY

16. Treasury management is an integral part of the financial management of the Authority. Utilising approved borrowing and investment strategies will maximise investment income whilst minimising exposure to liquidity and market risks.

FINANCIAL/RESOURCES/VALUE FOR MONEY IMPLICATIONS

17. The continued approach to investment of surplus funds is designed to further mitigate against potential losses as a consequence of counterparty failure and reflects a prudent approach to treasury management activity.

LEGAL IMPLICATIONS

18. The Authority must comply with the requirements of the CIPFA Code of Practice on Treasury Management and the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008. This report ensures such compliance.

EQUALITY IMPACT ASSESSMENT/HR IMPLICATIONS

19. No direct issues arise from this report.

CORPORATE RISK MANAGEMENT IMPLICATIONS

20. The application of and regular monitoring thereafter of a prudent Treasury Management Policy and related Prudential Indicators ensures that the Authority effectively manages financial risks whilst minimising borrowing costs and maximising investment income. It is therefore key to good financial management and an important element of the Medium Term Financial Planning Process.

HEALTH AND SAFETY IMPLICATIONS

21. No issues arising.

COMMUNICATIONS ACTIONS ARISING

22. No direct issues arising.

DETAILS OF CONSULTATION

23. The Authority's treasury management strategy has been developed using market information and specialist advice supplied by the Authority's treasury management advisors.

BACKGROUND PAPERS

24. 'Treasury Management and Capital Expenditure Prudential Indicators, Treasury Management Policy Statement 2014/15 and Minimum Revenue Provision (MRP) for 2014/15' – Report to Fire Authority March 2014.
CIPFA Code of Practice on Treasury Management 2009

RECOMMENDATION RESTATED

25. That Members take assurance from the treasury management activities undertaken during 2014/15 and the Prudential Indicators as outlined in paragraphs 14 and 15 and detailed in Appendix 1.

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