APPENDIX A

Annual Treasury Management Review 2014/15

PENDLE BOROUGH COUNCIL

September 2015

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Annual Treasury Management Review 2014/15

1. Introduction

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. 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 2014/15 the minimum reporting requirements included the following reports:

- an annual treasury strategy in advance of the year (Council 27/03/2014)
- a mid-year (minimum) treasury update report (Executive 23/10/2014)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

In addition, quarterly monitoring reports have been presented to the Accounts and Audit Committee providing information on the treasury activity undertaken and demonstrating compliance with the strategy approved by Council.

The regulatory environment places responsibility on Councillors 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 Councillors.

2. The Economy and Interest Rates

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.

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.

3. Overall Treasury Position as at 31 March 2015

At the beginning and the end of 2014/15 the Council's treasury (excluding finance leases) position was as follows:

TABLE 1	31 March 2014 Principal £m	Rate/ Return	Average Life yrs	31 March 2015 Principal £m	Rate/ Return	Average Life yrs
Total debt	**9.4**	**3.0%[1]**	**9.6[2]**	**14.4**	**3.38%**	**13.4**
CFR	**13.5**			**14.3**		
Over / (under) borrowing	**(4.1)**			**0.1**		
Total investments	**11.95**	**0.6%**	**All <1yr**	**18.35**	**0.57%**	**All <1yr**
Net debt / (investment)	**(2.55)**			**(3.95)**		

[1] Includes a 364 day loan of £1.5m @ 0.58% (average excluding this is 3.5%)
[2] Average life excluding the one short-term loan is 10.9yrs

4. The Strategy for 2014/15

The expectation for interest rates within the strategy for 2014/15 anticipated low but rising Bank Rate (starting in quarter 1 of 2015), and gradual rises in medium and longer term fixed borrowing rates during 2014/15. 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.

In this scenario, the treasury strategy was to postpone borrowing to avoid the cost of holding higher levels of investments and to reduce counterparty risk.

The actual movement in gilt yields meant that PWLB rates saw little overall change during the first four months of the year but there was then a downward trend for the rest of the year with a partial reversal during February.

The Council started the year in an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement) has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This was a prudent strategy as investment returns remained low and counterparty risk relatively high. However, during the year action was taken to address this position in view of the Council's underlying need to borrow, the medium-term forecast for PWLB rates and the relatively low PWLB rates which were available during 2014/15, most notably in the first quarter of 2015.

Against this backdrop decisions taken during the year led to net additional borrowing of £5m from the PWLB including £2m borrowed in advance. It was originally intended to borrow this money in 2015/16 but for the reasons outlined above the sum of £2m was borrowed earlier than planned to finance the planned capital programme.

5. The Borrowing Requirement and Debt

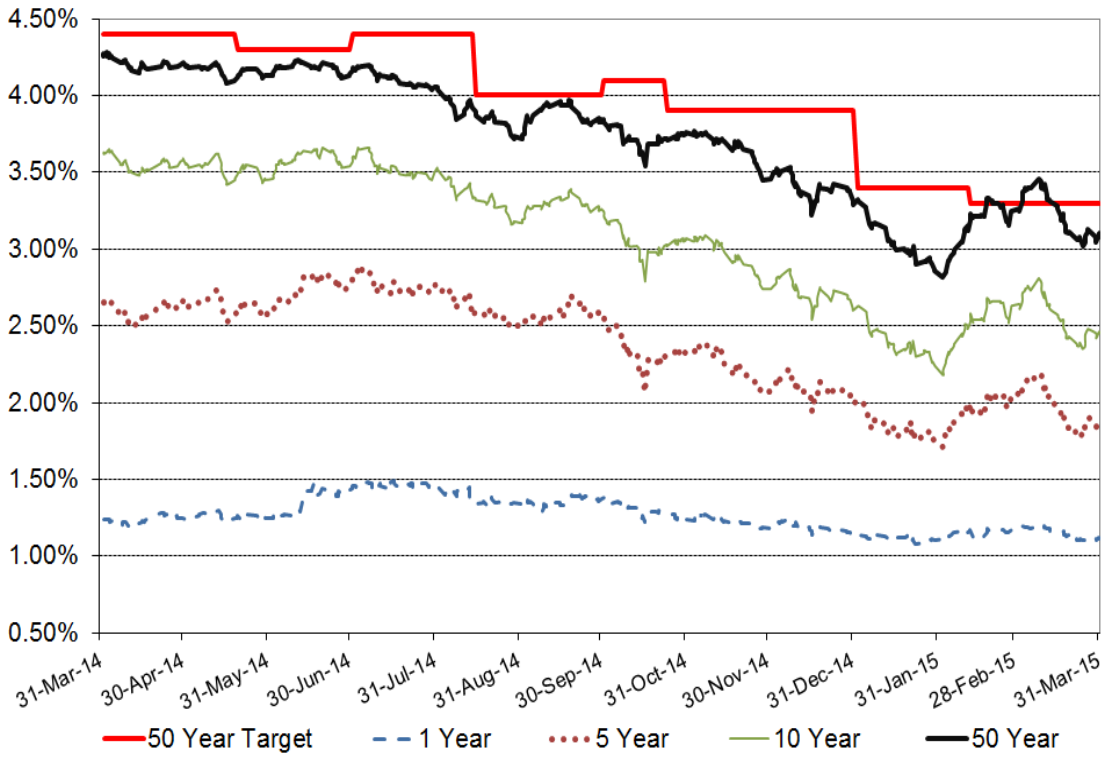
The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).

	31 March 2014 Actual	31 March 2015 Budget	31 March 2015 Actual
CFR General Fund (£m)	13.5	21.3	14.3
Total CFR	13.5	21.3	14.3

The variance from actual to budget for 2014/15 is primarily due to the significant slippage on the capital programme in the year as reported to the Executive in June 2015 (c£6m). This delays the associated borrowing 'need' as expressed by the Capital Financing Requirement.

6. Borrowing Rates in 2014/15

PWLB borrowing rates - the graph below shows how PWLB certainty rates have fallen to historically very low levels during the year.



7. Borrowing Outturn for 2014/15

Borrowing – the following loans were taken during the year: -

Lender	Principal	Type	Interest Rate	Maturity
PWLB	£6.5m (5 loans)	Fixed interest rate	2.82% - 3.49%	8 – 49 yrs

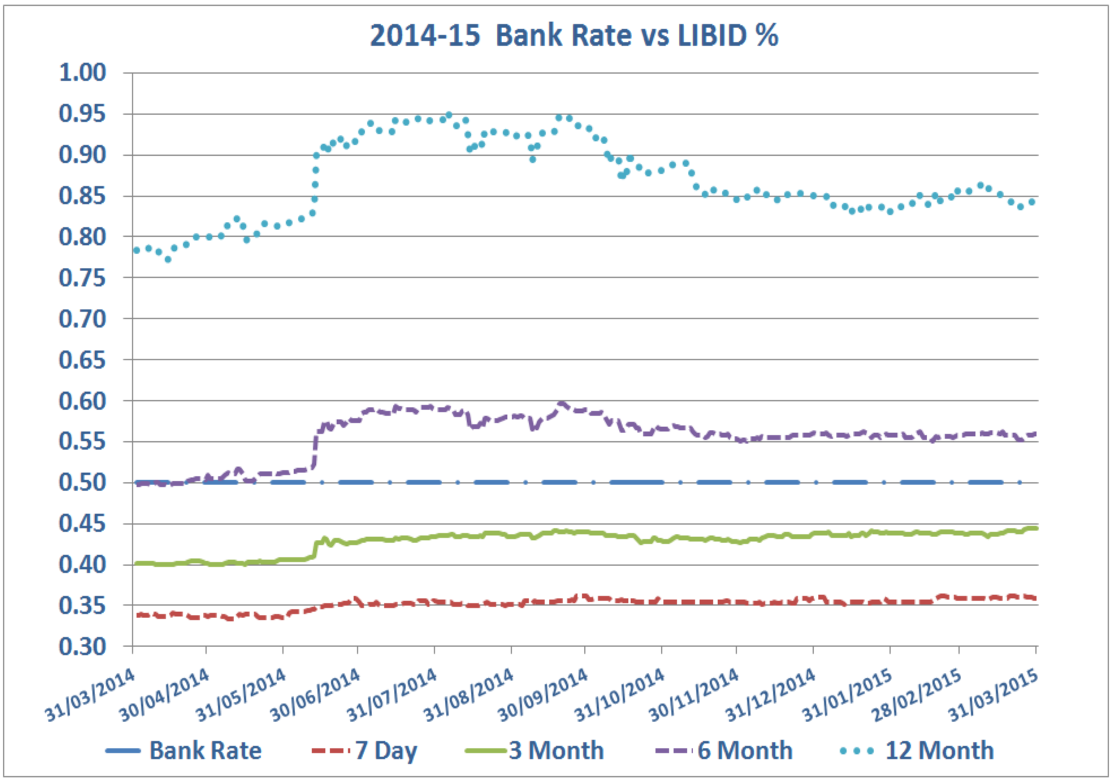
Given the volatility in PWLB rates during Q1 2015 £2m was borrowed in advance to support the 2015/16 capital programme.

Debt 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.

Repayments
The temporary 'market' loan of £1.5m was repaid to the Lender in February 2015 resulting in net additional borrowing of £5m for the year.

8. Investment Rates in 2014/15

Bank Rate remained at its historic low of 0.5% throughout the year; it has now remained unchanged for six years. Market expectations as to the timing of the start of monetary tightening started the year at quarter 1 2015 but then moved back to around quarter 3 2016 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.



9. Investment Outturn for 2014/15

Investment Policy – the Council's investment policy is governed by CLG guidance, which has been implemented in the annual investment strategy approved by the Council in March 2014. 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.

Investments held by the Council - the Council maintained an average balance of £17.9m of internally managed funds. The internally managed funds earned an average rate of return of 0.59%. Comparable performance indicators are the average 7-day LIBID rate, which was 0.35% or the 3-Month LIBID rate which was 0.43%. This compares with a budget assumption of £10m investment balances earning an average rate of 0.75%.

Appendix 1: Prudential and Treasury Indicators

During 2014/15, 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:

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 (2014/15) plus the estimates of any additional capital financing requirement for the current (2014/15) 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 borrow in advance of its immediate capital needs in 2014/15.

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 2014/15 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.

1. PRUDENTIAL INDICATORS	**2013/14**	**2014/15**	**2014/15**
Extract from budget setting report	**actual**	**original**	**actual**
	£'000	**£'000**	**£'000**
Capital Expenditure • **Includes slippage from 13/14 estimated at Jan 2014**	5,669	8,040*	5,784
Ratio of Financing Costs to Net Revenue Stream	3.75%	6.92%	5.48%
Gross borrowing requirement General Fund			
brought forward 1 April	12,747	16,316	13,478
carried forward 31 March	13,478	21,293	14,286
in year borrowing requirement	731	4,977	808
Capital Financing Requirement	13,478	21,293	14,286
Gross Debt	9,359	14,859	14,359
Incremental impact of capital investment decisions			
Increase in council tax (band D) per annum *	£33.12	£13.23	£43.06

Treasury Management Indicators	2014/15
Authorised limit (debt only)	£18.0m
Maximum gross borrowing position (Feb 2015)	£15.86m
Actual gross borrowing at 31/3/2015	£14.36m
Operational boundary (debt only)	£16.0m
Average gross borrowing position	£12.45m
Financing costs as a proportion of net revenue stream	5.48%

The maturity structure of the Council's debt portfolio was as follows:

	31 March 2014 actual	2014/15 original limits	31 March 2015 actual
Under 12 months	£1.50m	25%	£1.00m (7%)
12 months and within 24 months	£0.00m	40%	£0.00m
24 months and within 5 years	£2.00m	60%	£2.00m (14%)
5 years and within 10 years	£3.00m	80%	£4.00m (28%)
Over 10yrs	£2.86m	100%	£7.36m (51%)

The maturity structure of the investment portfolio was as follows:

	2013/14 Actual £m	2014/15 Original £m	2014/15 Actual £m
Investments All investments under 1 year	11.95	10.00	18.35

The exposure to fixed and variable rates was as follows:

	31 March 2014 Actual	2014/15 Original Limits	31 March 2015 Actual
Fixed rate (principal or interest) based on net debt	100%	100%	100%
Variable rate (principal or interest) based on net debt	0%	25%	0%
Limits on fixed interest rates (with variable rates shown in brackets): • Debt only • Investments only	100% (0%) 100% (0%)	100% (25%) 100% (25%)	100% (0%) 100% (0%)