APPENDIX A

Annual Treasury Management Review

2015/16

PENDLE BOROUGH COUNCIL

August 2016

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Annual Treasury Management Review 2015/16

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 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 included the following reports:

- an annual treasury strategy in advance of the year (Council 26/03/2015)
- a mid-year (minimum) treasury update report (Executive 22/10/2015)
- 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

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 UK elected a majority Conservative Government in May 2015. 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.

3. Overall Treasury Position as at 31 March 2016

At the beginning and the end of 2015/16 the Council's treasury (excluding finance leases) position was as follows:

TABLE 1	31 March 2015 Principal £m	Rate/ Return	Average Life yrs	31 March 2016 Principal £m	Rate/ Return	Average Life yrs
Total debt	**14.6**	**3.38%**	**13.4**	**15.4**	**3.41%**	**16.4**
CFR	**14.3**			**13.8**		
Over / (under) borrowing	**0.1**			**1.6**		
Total investments	**18.35**	**0.57%**	**All <1yr**	**17.80**	**0.46%**	**All <1yr**
Net debt / (investment)	**(3.95)**			**(2.40)**		

4. The Strategy for 2015/16

The expectation for interest rates within the treasury management strategy for 2015/16 anticipated a 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.

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

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.

The Council started the year in a marginally over-borrowed position. This means that the council's loan debt exceeded the capital borrowing need (the Capital Financing Requirement). This position is permissible in the short-term within the framework applicable to local authorities. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

5. The Borrowing Requirement and Debt

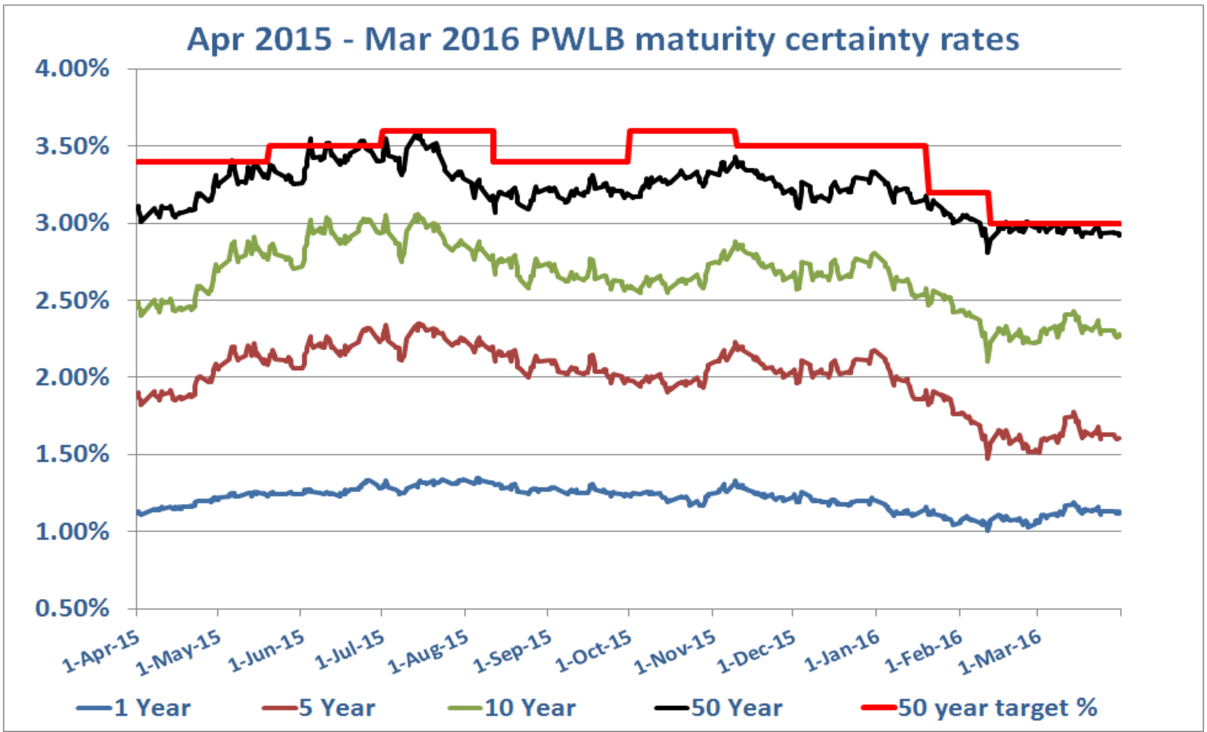
The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).

	31 March 2015 Actual	31 March 2016 Budget	31 March 2016 Actual
CFR General Fund (£m)	14.3	21.8	13.8

The variance from actual to budget for 2015/16 is due to the significant slippage on the capital programme in the year as reported to the Executive in June 2016 (£7.5m). This delays the associated borrowing 'need' as expressed by the Capital Financing Requirement. The reduction of £0.5m in the CFR as at 31/3/16 from the previous year reflects the charge made to revenue budget for the Minimum Revenue Provision (MRP).

6. Borrowing Rates in 2015/16

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 2015/16

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

Lender	Principal	Type	Interest Rate	Maturity yrs
PWLB PWLB	£1m £1m	Both fixed interest maturity loans	3.07% 2.91%	46.6 18.1

The Treasury Strategy approved by Council in March 2015 envisaged net additional borrowing of £2.5m during 2015/16 comprised of net 'normal' borrowing of £1m and a further £1.5m to support the Brownfield Regeneration Fund. This latter borrowing was not progressed in the year.

Repayments

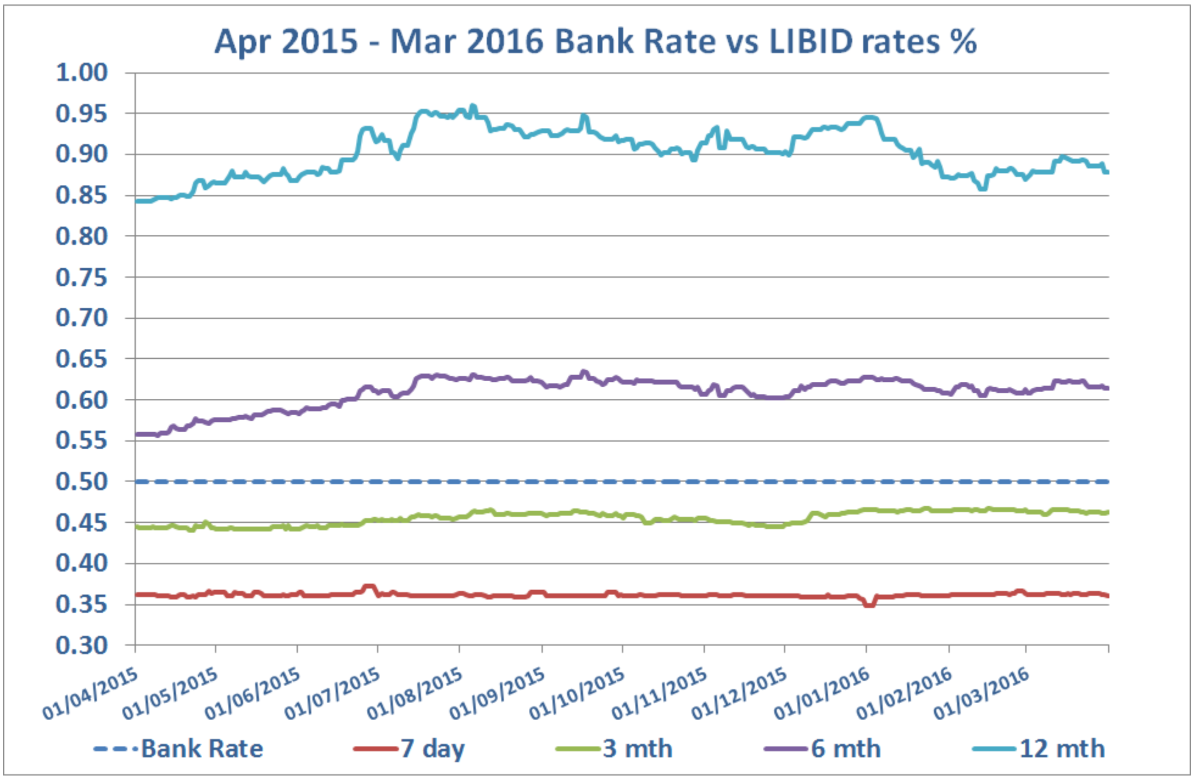
A loan for £1m was repaid to the PWLB on maturity on 31st March 2016. This combined with the 2 new loans taken out totalling £2m resulted in net additional borrowing of £1m for the year as per the approved Strategy.

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.

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 guidance, which has been implemented in the annual investment strategy approved by the Council in March 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.

Investments held by the Council - the Council maintained an average balance of £22.5m of internally managed funds. The internally managed funds earned an average rate of return over the year of 0.51%. Comparable performance indicators are the average 7-day LIBID rate, which was 0.36% or the 3-Month LIBID rate which was 0.46%. This compares with a budget assumption of £10m investment balances earning an average rate of 0.70%.

Appendix 1: Prudential and Treasury Indicators

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:

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 allows the Council some flexibility to borrow in advance of its immediate capital needs in 2015/16.

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.

1. PRUDENTIAL INDICATORS	2014/15	2015/16	2015/16
Extract from budget setting report	**actual**	**original**	**actual**
	£'000	**£'000**	**£'000**
Capital Expenditure • **Includes slippage from 14/15 estimated at Jan 2015**	5,784	7,948*	2,511
Ratio of Financing Costs to Net Revenue Stream	5.48%	7.30%	6.45%
Gross borrowing requirement General Fund			
brought forward 1 April	13,478	16,082	14,286
carried forward 31 March	14,286	21,818	13,782
in year borrowing requirement	808	5,736	(504)
Capital Financing Requirement	14,286	21,818	13,781
Gross Debt	14,359	16,859	15,359
Incremental impact of capital investment decisions			
Increase in council tax (band D) per annum	£43.06	£33.24	£37.03

Treasury Management Indicators	2015/16
Authorised limit	£23.5m
Maximum gross borrowing position (Feb 2016)	£16.50m
Actual gross borrowing at 31/3/2016	£15.50m
Operational boundary	£22.5m
Average gross borrowing position	£15.3m
Financing costs as a proportion of net revenue stream	6.45%

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

	31 March 2015 actual	2015/16 original limits (upper)	31 March 2016 actual
Under 12 months	£1.00m (7%)	25%	£0.00m (0%)
12 months and within 24 months	£0.00m (0%)	30%	£1.00m (6%)
24 months and within 5 years	£2.00m (14%)	40%	£2.00m (13%)
5 years and within 10 years	£5.00m (35%)	60%	£5.50m (36%)
Over 10yrs	£6.36m (44%)	100%	£6.86m (45%)

The maturity structure of the investment portfolio was as follows:

	2014/15 Actual £m	2015/16 Original £m	2015/16 Actual £m
Investments All investments under 1 year	18.35	10.00	17.8

Upper limits for exposure to fixed and variable rates of interest were as follows:

	31 March 2015 Actual	2015/16 Original Limits	31 March 2016 Actual
Fixed rate (interest) based on net debt	100%	100%	104%
Variable rate (interest) based on net debt	0%	25%	-4%
Upper 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%) 78% (22%)