Report to: Cabinet

Date of Meeting: 5 September 2016

Report Title: Annual Treasury Management Report 2015-16

Report By: Peter Grace

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Purpose of Report

This report provides the opportunity for the Cabinet to scrutinise the Treasury Management activities and performance of the last financial year. This report will be considered by the Audit Committee at its meeting on 22 September 2016.

Recommendation(s)

1. **To consider the report – no recommendations are being made to amend the current Treasury Management Strategy as a result of this particular review.**
2. **Full Council to consider the report and any recommendations made by Cabinet.**

Reasons for Recommendations

To ensure that members are fully aware of the activities undertaken in the last financial year, that Codes of Practice have been complied with and that the Council's strategy has been effective in 2015-16.

Under the Code adopted the full Council is required to consider the report and any recommendations made.

Introduction

1. The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2009 was adopted by this Council on 15th February 2010 and this Council fully complies with its requirements.

2. The primary requirements of the Code are as follows:

   a) Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

   b) Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.

   c) Receipt by the Full Council of an annual treasury management strategy report (including the annual investment strategy report for the year ahead, a mid-year review report (as a minimum) and an annual review report of the previous year.

   d) Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

   e) Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body which in this Council is the Audit Committee.

3. Treasury management in this context is defined as:
   "The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

4. The purpose of this report is to meet one of the above requirements of the CIPFA Code, namely the annual review report of treasury management activities, for the financial year 2015-16.

5. This annual Treasury report covers

   a) capital expenditure and financing 2015-16

   b) overall borrowing need (the Capital Financing Requirement)

   c) treasury position as at 31 March 2016;

   d) performance for 2015-16;

   e) the strategy for 2015-16;

   f) the economy and interest rates in 2015-16;

   g) borrowing rates in 2015-16;

   h) the borrowing outturn for 2015-16;

   i) debt rescheduling;

   j) compliance with treasury limits and Prudential Indicators;

   k) investment rates in 2015-16;

l) investment outturn for 2015-16;

The Council's Capital Expenditure and Financing 2015/16

6. 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.

Capital Programme Financing 2015-16		Outturn 2015-16 £000's
Expenditure :		4,434
Financed by :		
Borrowing		0
Grants - Disabled Facilities grant	737	
Lottery Grants		
Costal Communities	75	
Coastal Revival Fund	50	
Interreg	2	
Regional Housing Board	11	
Hastings and St Leonards Foreshore charitable Trust	627	
East Sussex County Council	300	
Environment Agency	78	
Renovation Grant Repayments	145	
Historic England	97	
S106 Contributions	41	
Other Grants and Contributions	25	
		2,188
Reserves	757	
Capital Receipts	1,489	
		4,434

* table above excludes £300,000 loan made to the Foreshore Trust in respect of white rock baths expenditure

The Council's Overall Borrowing Need

7. 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 debt position. The CFR results from the capital activity of the Council and what resources have been used to pay for the capital spend.

8. Part of the Council's treasury activities is to address the funding requirements for the Council's borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure 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.

9. 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 is required to make an annual revenue charge, called the Minimum Revenue Provision – MRP, to reduce the CFR. This 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.

10. 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).

11. The Council's 2015/16 MRP Policy was approved as part of the Treasury Management Strategy Report for 2015/16 by Council in February 2015.

12. 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 this scheme.

Table 2 CFR: General Fund	2014/15 Actual £000's	2015/16 Estimate £000's	2015/16 Actual £000's
Opening balance	16,372	18,572	18,572
Add unfinanced capital expenditure	2,697	660	300
Less MRP	(488)	(511)	(511)
Less finance lease arrangements	(9)	(9)	(9)
Closing balance	**18,572**	**18,712**	**18,352**

13. Borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit.

14. The Council's long term borrowing must only be for a capital purpose. This essentially means that the Council is not borrowing to support revenue expenditure. Net borrowing should not therefore, except in the short term, have exceeded the CFR for 2015/16 plus the expected changes to the CFR over 2015/16 and 2016/17 from financing the capital programme. This indicator allows 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, which provides an indication of affordability for the Council. The Council has complied with this prudential indicator.

Table 3 Internal Borrowing Level	2014/15 Actual	2015/16 Estimate	2015/16 Actual
	£000's	£000's	£000's
Capital Financing Requirement	18,572	18,712	18,352
External Borrowing	14,197	14,197	14,497
Net Internal Borrowing	4,375	4,515	3,855

Treasury Position as at 31 March 2015

15. The Council's debt and investment position at the beginning and the end of the year was as follows:

Table 4 **Debt**	31st March 2015 Principal	Annual Rate	Maturity	31st March 2016 Principal	Annual Rate
PWLB Loan1	£7.5m	4.80%	2033	£7.5m	4.80%
PWLB Loan 2	£1.0m	2.02%	2016	£1.0m	2.02%
PWLB Loan 3	£1.0m	1.63%	2018	£1.0m	1.63%
PWLB Loan 4	£0.9m	3.78%	2044	£0.9m	3.78%
PWLB Loan 5	£1.8m	3.78%	2044	£1.8m	3.78%
				£0.3m	1.66%
Fixed Rate Debt	£9.5m			12.5m	
PWLB Loan 6	£2.0m	0.55% (Variable Rate)	2019	£2.0m	0.56% (Variable Rate)
Total Debt	£11.5m	3.55%		£14.5m	3.55%

Table 5 **Investments**	31st March 2015 Principal	31st March 2016 Principal
-In-House *	£21.9m	£22.5m
Total Investments*	£21.9m	£22.5m

* excludes deposits held in respect of the Local Authority Mortgage Scheme

Performance Measurement (2015-16)

16. Table 6 below compares the Estimated Interest Payable and Received and associated fees for the year 2015-16.

Table 6	2014 -15 Actual Outturn £000's	2015 -16 Revised Budget £000's	2015 -16 Actual Outturn £000's
Gross Interest Payable	472	514	574
Gross Interest Received	(229)	(286)	(386)
Fees	13	13	13
Other (e.g. PWLB Discount)	(53)	(51)	(51)
Net Cost	203	190	150

17. There is a variance from the revised budget due to variations between budgeted and actual rates achieved and a £13,000 exchange rate gain.

18. The net interest on the LAM scheme (as below) is being transferred into the mortgage reserve.

Table 7	2014 -15 Actual Outturn £000's	2015 -16 Revised Budget £000's	2015 -16 Actual Outturn £000's
Gross Interest Payable	36	36	36
Gross Interest Received	(64)	(64)	(68)
Net Surplus	(28)	(28)	(32)

19. The Council’s longer term cash balances comprise, primarily, revenue and capital resources, although these will be influenced by cash flow considerations. The Council’s core cash resources are detailed below, and were in line with budget expectations.

Table 8 Balance Sheet	31 March 2015	31 March 2016
	£000’s	£000’s
General Fund Balance	500	500
Earmarked Reserves	11,078	11,926
General Reserves	8,583	8,400
Total	£19,661	£20,326

The Strategy for 2015-16

20. The expectation for interest rates within the strategy for 2015/16 anticipated low but rising Bank Rate (starting in quarter one of 2015), and gradual rises in medium and longer term fixed borrowing rates during 2015/16. 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 has promoted a cautious approach, whereby investments decisions are dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

21. In this scenario, the treasury strategy was to postpone borrowing to avoid the cost of holding higher levels of investments and reduce counterparty risk except where contractual arrangements with Amicus Horizon were involved.

The Economy and Interest Rates

22. In UK GDP growth rates in 2013 of 2.2% and 2.9% in 2014 were the strongest growth rates of any G7 country. However, the 2015 growth rate finally came in at a disappointing 1.8%, though it still remained one of the leading rates among the G7 countries. Growth was +0.4% in quarter 1 and +0.6% in quarter 2, (first estimate), but forward looking indicators point to a sharp slowdown in the second half of 2016 as a result of the Brexit vote. During most of 2015, the economy had

faced headwinds for exporters from the appreciation during the year of sterling against the Euro, and weak growth in the EU, China and emerging markets, plus the dampening effect of the Government's continuing austerity programme and uncertainty created by the Brexit referendum. However, since the peak in November 2015, sterling has fallen in value, especially after the referendum result, which will help to make British goods and services much more competitive and will increase the value of overseas earnings by multinational companies based in the UK. In addition, the Chancellor has announced that the target of achieving a budget surplus in 2020 will have to be eased in order to help the economy recover from the expected slowing of growth during the second half of 2016. He has also said he will do 'whatever is needed' to stimulate growth which could mean fiscal policy action e.g. cutting taxes, increasing investment allowances for businesses etc and / or increasing government expenditure on infrastructure, housing etc.

23. In the Eurozone, the ECB commenced in March 2015 its massive €1.1 trillion programme of quantitative easing to buy high credit quality government and other debt of selected EZ countries at a rate of €60bn per month; this was intended to run initially to September 2016. In response to a continuation of weak growth, at the ECB's December meeting, this programme was extended to March 2017 but was not increased in terms of the amount of monthly purchases. At its December and March meetings it progressively cut its deposit facility rate to reach -0.4% and its main refinancing rate from 0.05% to zero. At its March meeting, it also increased its monthly asset purchases to €80bn. This programme of monetary easing has had a limited positive effect in helping a recovery in consumer and business confidence and an initial start to some improvement in economic growth. GDP growth rose by 0.6% in quarter 1 2016 (1.7% y/y) but disappointed in quarter 2 with a reversal to only 0.3% (1.6% y/y). The ECB is also struggling to get inflation up from near zero towards its target of 2%.

Borrowing Rates in 2015-16

24. PWLB borrowing rates - the graphs and table for PWLB maturity rates below show, for a selection of maturity periods, the high and low points in rates, the average rates, spreads and individual rates at the start and the end of the financial year.

Table 9: PWLB maturity certainty rates

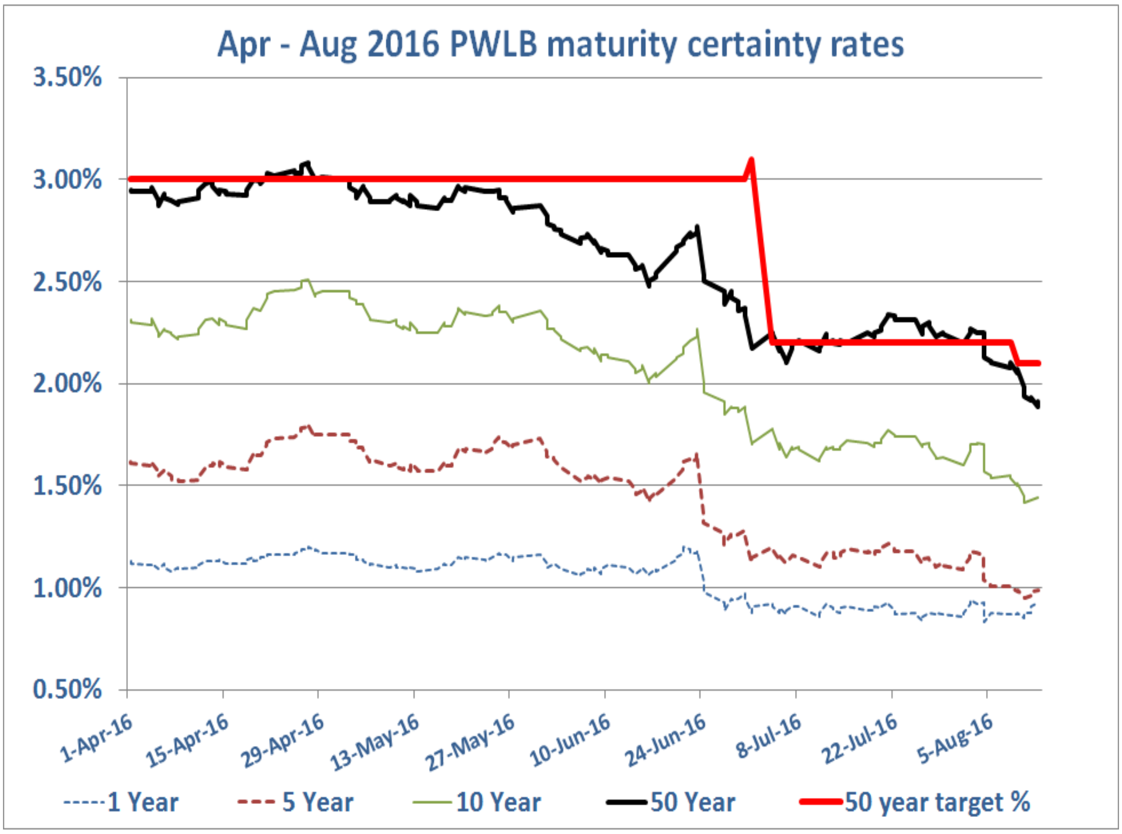

Table 10: PWLB certainty rates quarter ended 31.3.2016

	1 Year	5 Year	10 Year	25 Year	50 Year
1/4/16	1.13%	1.62%	2.31%	3.14%	2.95%
15/8/16	0.92%	0.98%	1.19%	1.34%	1.57%
Low	0.83%	0.95%	1.42%	2.08%	1.89%
Date	04/08/2016	10/08/2016	10/08/2016	12/08/2016	12/08/2016
High	1.20%	1.80%	2.51%	3.28%	3.08%
Date	27/04/2016	27/04/2016	27/04/2016	27/04/2016	27/04/2016
Average	1.04%	1.43%	2.05%	2.84%	2.61%

25. The table above highlights the fluctuation in borrowing rates throughout the year for different borrowing periods (in years). Members would be able to scrutinise the timing of any borrowing decisions with this information.

Borrowing Outturn for 2015/16

26. The additional long term borrowing £0.3m was undertaken in 2015/16 was in respect of the Foreshore Trust and the White Rock Baths.

Debt Rescheduling

27. The Council examined the potential for making premature debt repayments in order to reduce borrowing costs as well as reducing counterparty risk by reducing investment balances. No rescheduling was undertaken during the year as the

differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

Compliance with Treasury Limits

28. During the financial year the Council operated within the treasury limits and Prudential Indicators set out in the Council's annual Treasury Strategy Statement. The outturn for the Prudential Indicators is shown in Appendix 1.

Investment Rates in 2015-16

29. Investment rates available in the market have continued at historically low levels and have fallen further during the last year. The funds invested during the year were often available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the capital programme. The Council holds approximately £22m core cash balances for investment purposes.

30. The table below shows the bank base rate and the PWLB rates forecasts.

Table 11 PWLB certainty rates

	Mar 16	Jun 16	Sep 16	Dec 16	Mar 17	Jun 17	Sep 17	Dec 17	Mar 18	Jun 18	Sep 18	Dec 18	Mar 19
Bank Rate View	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%
5yr PWLB Rate	2.00%	2.10%	2.20%	2.30%	2.40%	2.50%	2.60%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%
10yr PWLB Rate	2.60%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.60%	3.60%	3.70%
25yr PWLB Rate	3.40%	3.40%	3.50%	3.60%	3.70%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%	4.10%	4.10%
50yr PWLB Rate	3.20%	3.20%	3.30%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	3.90%	4.00%	4.00%	4.00%

Investment Strategy

31. The strategy has not changed during the year, other than Investment returns being lower and for a longer period than previously anticipated, although a further base rate fall looks more likely in late 2016 or early 2017.

Investment Outturn for 2015-16

32. Investments held by the Council - the Council maintained an average balance in the year of £23m. The average rate of return for the year was 0.66% (0.85% including LAMS scheme deposits). The comparable performance indicator is the average 7-day LIBID rate (un-compounded), which was 0.35%.

33. The table below provides a snapshot of the investments held at 31 March 2016.

Table 12: Counter Party	Rate / Return	Start Date	End Date	Principal	Term
Barclays	0.65%			£1.5m	Call account
Heleba Landesbank	0.74%	15/01/2016	15/07/2016	£3.0m	Fixed Term Deposit
National Australia Bank	0.60%	01/10/2015	01/04/2016	£3.0m	Fixed Term Deposit
Nordea Bank	0.60%	01/10/2014	01/04/2015	£5m	Certificate of Deposit
RBS - NatWest	0.60%	21/08/2013		£5m	Call account
Lloyds	1.00%	10/04/2015	08/0416	£5m	Fixed Term Deposit
				£22.5m	

The above table excludes two £1million deposits that are held with Lloyds bank as part of the Local Authority Mortgage scheme; the deposits are held for periods of 5 years.

34. No institutions in which investments were made during 2015/16 had any difficulty in repaying investments and interest in full during the year.

Financial Implications

35. The security of the Council's monies remains the top priority within the strategy. The past year has seen the continuing historically low level of interest rates available to investors. There has been some new borrowing, of which £300,000 represents a loan made to the Foreshore Trust.

36. The net position once borrowing costs and investment interest are considered is a net decrease in costs from £203,000 in 2014/15 to £150,000 in 2015/16. This is partly the result of the reprofiling of the lending to and grant payment to Amicus Horizon and Foreshore Trust but also recognition of investment income from the return of a longer term investment which matured in year

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Wards Affected

Ashdown, Baird, Braybrooke, Castle, Central St. Leonards, Conquest, Gensing, Hollington, Maze Hill, Old Hastings, Ore, Silverhill, St. Helens, Tressell, West St. Leonards, Wishing Tree

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Area(s) Affected

Central Hastings, East Hastings, North St. Leonards, South St. Leonards

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Policy Implications

Please identify if this report contains any implications for the following:

Equalities and Community Cohesiveness No
Crime and Fear of Crime (Section 17) No
Risk Management No

Environmental Issues	No
Economic/Financial Implications	Yes
Human Rights Act	No
Organisational Consequences	No
Local People's Views	No

Background Information

Treasury Management and Annual Investment Strategy 2015/16
CIPFA - Treasury Management Code of Practice (revised 2009)
CIPFA - The Prudential Code (revised 2009)

Officer to Contact

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Appendix 1: Prudential Indicators

PRUDENTIAL INDICATOR	2014/15	2015/16	2016/17	2017/18	2018/15
(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	£'000	£'000	£'000	£'000	£'000
Authorised Limit for external debt -					
borrowing	£20,000	£20,000	£20,000	£20,000	£20,000
other long term liabilities	£10,000	£10,000	£10,000	£10,000	£10,000
TOTAL	£30,000	£30,000	£30,000	£30,000	£30,000
Operational Boundary for external debt -					
borrowing	£20,000	£20,000	£20,000	£20,000	£20,000
other long term liabilities	£10,000	£10,000	£10,000	£10,000	£10,000
TOTAL	£30,000	£30,000	£30,000	£30,000	£30,000
Upper limit for fixed interest rate exposure Net principal re fixed rate borrowing / investments OR:-	100 %	100 %	100 %	100 %	100 %
Upper limit for variable rate exposure Net principal re variable rate borrowing / investments OR:-	100 %	100 %	100 %	100 %	100 %
Upper limit for total principal sums invested for over 364 days – LAMS Scheme and Coastal Space	£5,620	£6,000	£6,000	£6,000	£6,000

Maturity structure of fixed rate borrowing during 2013/14	upper limit	lower limit
under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%