Annual Treasury Management Review 2015/16

1. Introduction

This Authority 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 were that the full Authority should receive the following reports:

- an annual treasury strategy in advance of the year (Fire Authority 23/02/2015)
- a mid-year treasury update report (Fire Authority 17/02/2016)
- an annual review following the end of the year describing the activity compared to the strategy (this report).

The regulatory environment places responsibility on members 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 Authority's policies previously approved by members.

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 ECB commenced a full blown quantitative easing programme of purchases of Eurozone government and other bonds starting in March at €60bn per month. This put downward pressure on Eurozone bond yields. There was a further increase in this programme of QE in December 2015.

As for America, the economy has continued to grow healthily on the back of resilient consumer demand. The first increase in the central rate occurred in December 2015 since when there has been a return to caution as to the speed of further increases due to concerns around the risks to world growth.

The UK elected a majority Conservative Government in May 2015, removing one potential concern but introducing another due to the promise of a referendum on the UK remaining part of the EU. 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 Authority's treasury position was as follows:

TABLE 1	31 March 2015 Principal	Rate/ Return	Average Life yrs	31 March 2016 Principal	Rate/ Return	Average Life yrs
Total debt	***£8.842m***	***4.4%***	***13***	***£8.842m***	***4.4%***	***12***
CFR	***£6.706m***			***£6.367m***		
Over / (under) borrowing	***£2.136m***			***£2.475m***		
Total investments	***£2.782m***	***0.36%***		***£6.601m***	***0.54%***	
Net debt	**£6.060*m***			**£2.241m**		

4. The Strategy for 2015/16

The expectation for interest rates within the treasury management strategy for 2015/16 anticipated 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 would be to postpone 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.

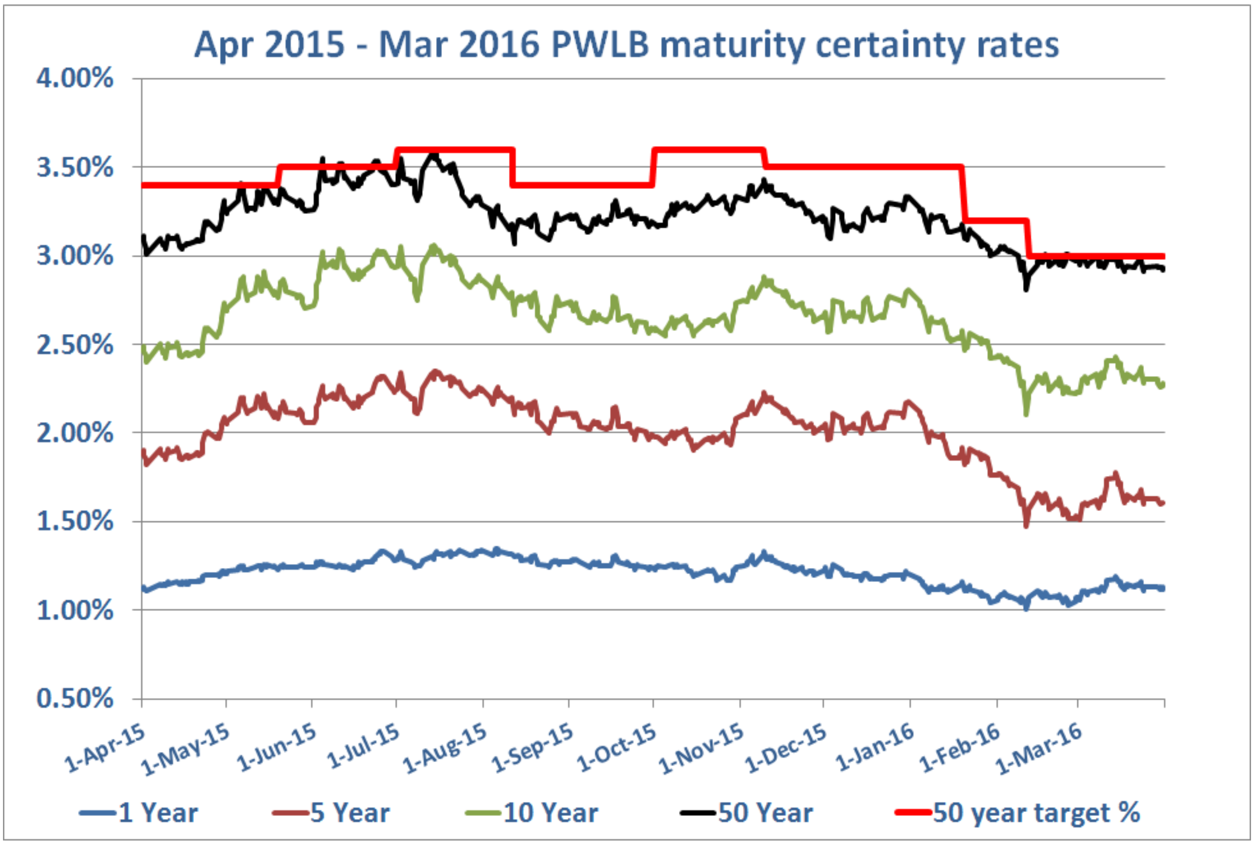
5. The Borrowing Requirement and Debt

The Authority'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	6.706m	6.360m	6.387m

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 –
No borrowing was undertaken during the year.

Rescheduling
No rescheduling was done during the year.

Repayments
No PWLB debt was repaid during the year.

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 Authority's investment policy is governed by CLG guidance, which has been implemented in the annual investment strategy approved by the Authority on 23/02/2015. 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 Authority had no liquidity difficulties.

Investments held by the Authority - the Authority maintained an average balance of £6.3 million of internally managed funds. The internally managed funds earned an average rate of return of 0.54%. The comparable performance indicator is the average 7-day LIBID rate was 0.36%. This compares with a budget assumption of balances earning an average rate of 0.30%.

Annex 1: Prudential and Treasury Indicators

During 2015/16, the Authority 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:

Actual prudential and treasury indicators	2014/15 Actual £000	2015/16 Original £000	2015/16 Actual £000
Capital expenditure	1,813	3,839	1,542
Capital Financing Requirement	6,706	6,360	6,367
External debt	8,842	8,842	8,842

Gross borrowing and the CFR –

The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Authority's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with asset life.

in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Authority 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 Authority is not borrowing to support revenue expenditure. The Authority met these criteria.

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 Authority does not have the power to borrow above this level. The table below demonstrates that during 2015/16 the Authority has maintained gross borrowing within its authorised limit.

The operational boundary – the operational boundary is the expected borrowing position of the Authority 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.

	2015/16
Authorised limit	£9.642m
Maximum gross borrowing position	£8.842m
Operational boundary	£8.942m
Average gross borrowing position	£8.842m
Financing costs as a proportion of net revenue stream	2.2%

Ratio of financing costs to net revenue stream	2014/15 actual	2015/16 original limits	31 March 2016 actual
	2.4%	2.2%	2.2%

Incremental impact of capital investment decisions	31 March 2014 actual	2014/15 original limits	31 March 2015 actual
Increase in council tax (band D) per annum	£0.00	£0.00	£0.00

	31 March 2015 Principal	Rate/ Return	Average Life yrs		31 March 2016 Principal	Rate/ Return	Average Life yrs
Fixed rate funding:							
-PWLB	£8.842m	4.40%	13		£8.842m	4.40%	12
CFR	£6.706m				£6.367m		
Over borrowing	£2.136m				£2.475m		

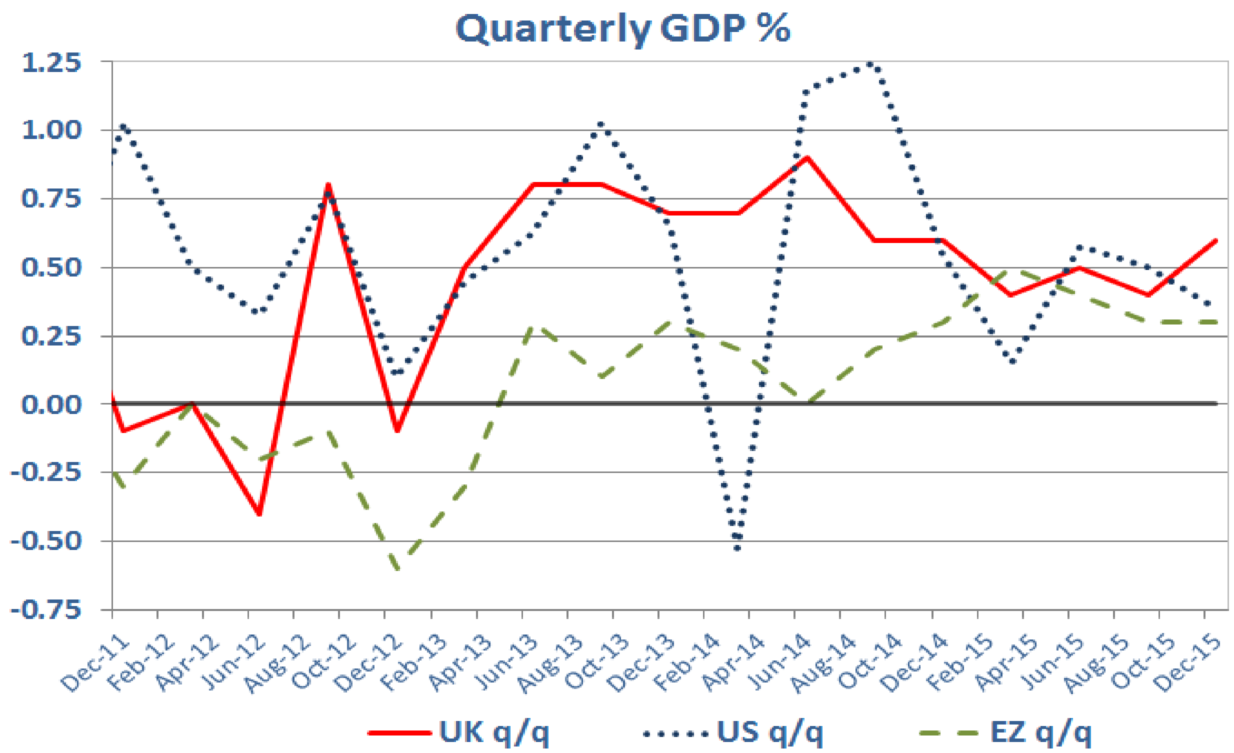
The maturity structure of the debt portfolio was as follows:

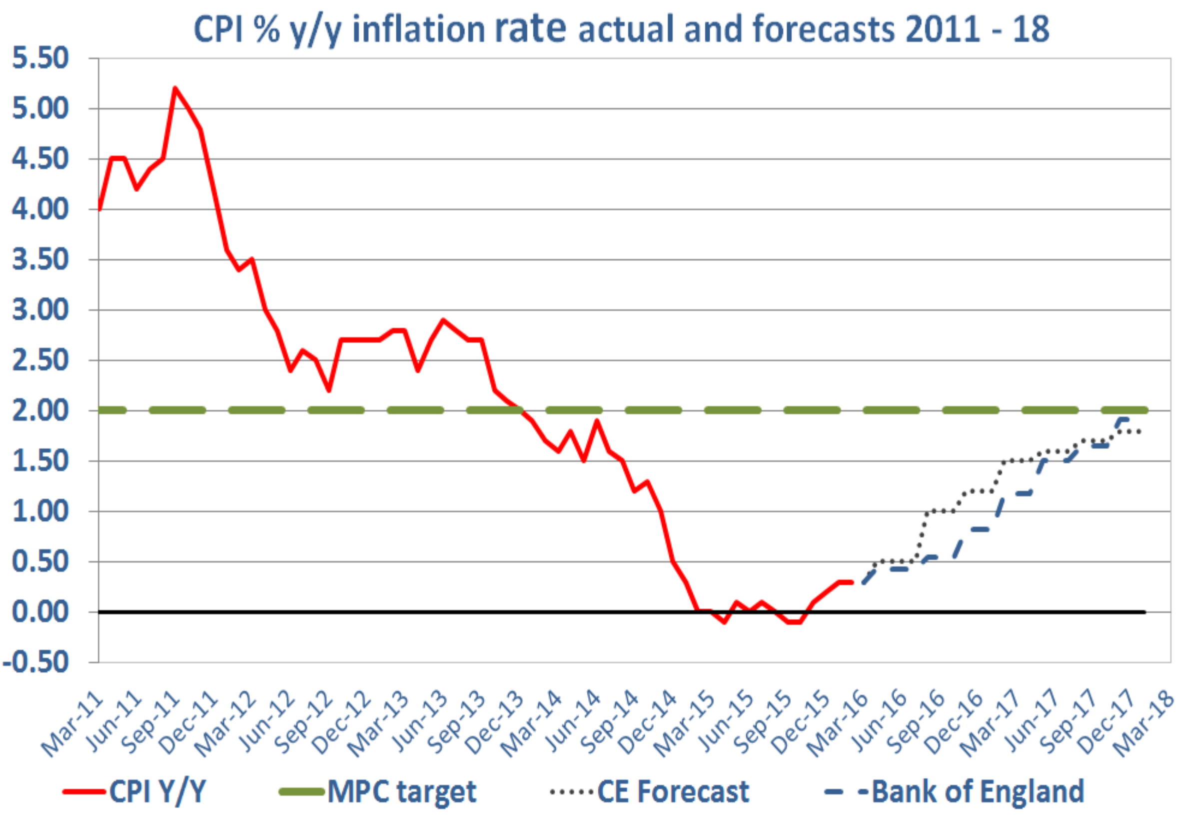
	31 March 2015 actual		31 March 2016 actual
24 months and within 5 years	0		£1.750m
5 years and within 10 years	£2.920m		£1.170m
10 years and within 20 years	£4.572m		£4.572m
20 years and within 30 years	£1.350m		£1.350m

The exposure to fixed and variable rates was as follows:

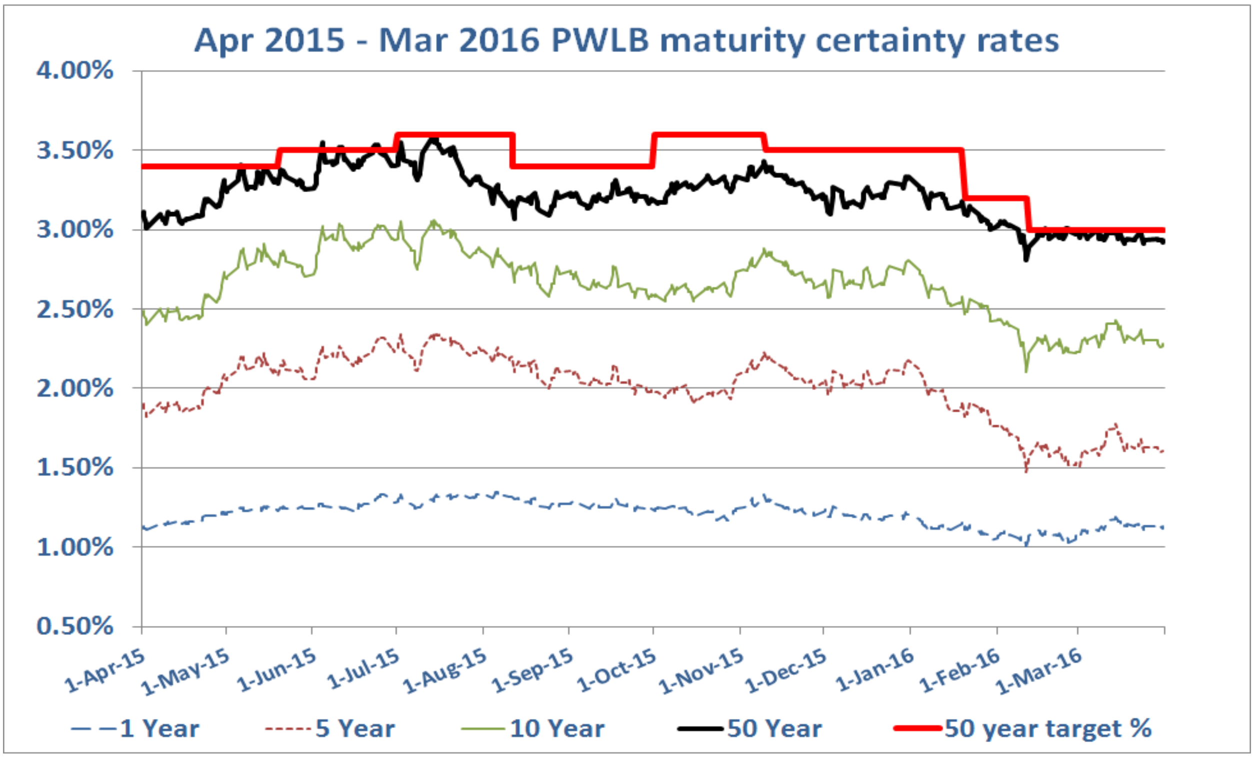
	31 March 2014 actual	2014/15 original limits	31 March 2015 actual
Fixed rate debt	100%	100%	100%
Variable rate investments	100%	100%	100%

Annex 2: Financial Market Information (Graphical Form)

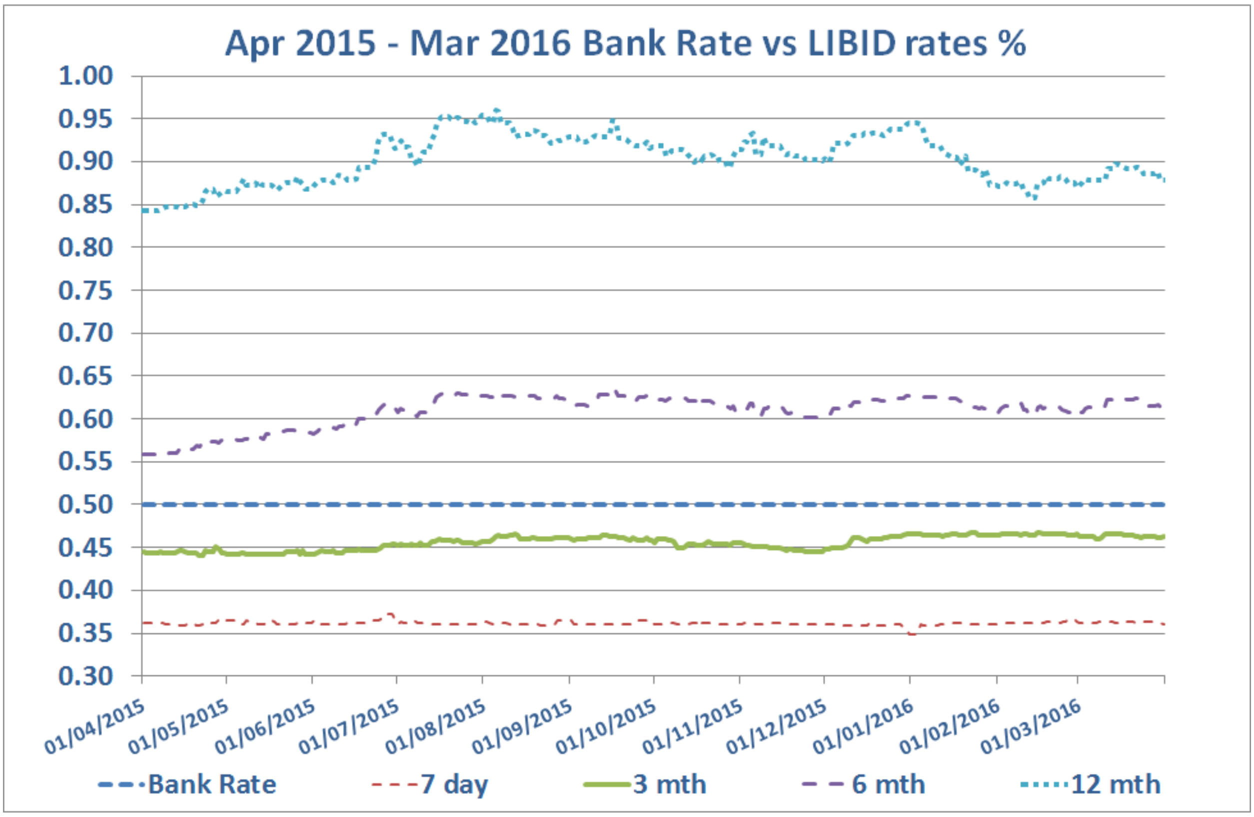




CPI % y/y inflation rate actual and forecasts 2011 - 18
5.50
5.00
4.50
4.00
3.50
3.00
2.50
2.00
1.50
1.00
0.50
0.00
-0.50
Mar-11 Jun-11 Sep-11 Dec-11 Mar-12 Jun-12 Sep-12 Dec-12 Mar-13 Jun-13 Sep-13 Dec-13 Mar-14 Jun-14 Sep-14 Dec-14 Mar-15 Jun-15 Sep-15 Dec-15 Mar-16 Jun-16 Sep-16 Dec-16 Mar-17 Jun-17 Sep-17 Dec-17 Mar-18
CPI Y/Y
MPC target
CE Forecast
Bank of England



Apr 2015 - Mar 2016 PWLB maturity certainty rates
4.00%
3.50%
3.00%
2.50%
2.00%
1.50%
1.00%
0.50%
1-Apr-15 1-May-15 1-Jun-15 1-Jul-15 1-Aug-15 1-Sep-15 1-Oct-15 1-Nov-15 1-Dec-15 1-Jan-16 1-Feb-16 1-Mar-16
1 Year
5 Year
10 Year
50 Year
50 year target %


Apr 2015 - Mar 2016 Bank Rate vs LIBID rates %
1.00
0.95
0.90
0.85
0.80
0.75
0.70
0.65
0.60
0.55
0.50
0.45
0.40
0.35
0.30
01/04/2015
01/05/2015
01/06/2015
01/07/2015
01/08/2015
01/09/2015
01/10/2015
01/11/2015
01/12/2015
01/01/2016
01/02/2016
01/03/2016
Bank Rate
7 day
3 mth
6 mth
12 mth