Finance and Audit Scrutiny Committee 28th July 2015.	**Agenda Item No. 4**

Title	2014/15 Annual Treasury Management Report
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Wards of the District directly affected	None
Is the report private and confidential and not for publication by virtue of a paragraph of schedule 12A of the Local Government Act 1972, following the Local Government (Access to Information) (Variation) Order 2006	No
Date and meeting when issue was last considered and relevant minute number	N/A
Background Papers	Treasury Management Annual Strategy Plan 2014/2015 Various documents from Capita Asset Services - Treasury Solutions

Contrary to the policy framework:	No
Contrary to the budgetary framework:	No
Key Decision?	No
Included within the Forward Plan? (If yes include reference number)	No
Equality & Sustainability Impact Assessment Undertaken	No – not relevant

Officer/Councillor Approval

Officer Approval	**Date**	**Name**
Chief Executive	08.07.2015	Andrew Jones
Head of Service	N/A	
CMT	N/A	
Section 151 Officer	13.07.2015	Mike Snow
Monitoring Officer	N/A	
Finance	08.07.2015	Roger Wyton
Portfolio Holder(s)	N/A	

Consultation & Community Engagement:	None
Final Decision?	Yes

Suggested next steps (if not final decision please set out below): N/A

1. Summary

1.1. The Council is required to report upon its 2014/15 Treasury Management performance by 30th September. This report therefore details and reviews the Council's performance for the whole of 2014/15 and is attached as Appendix A.

1.2 Consideration of the Council's Treasury Management activities is within the remit of the Finance and Audit Scrutiny Committee hence, it is appropriate to report the Council's annual performance direct to this Committee.

1.3 The report follows the format used in the Treasury Management Strategy Plan presented to the Executive on 12th March 2014 and comments, where appropriate, on the Council's actual performance against what was forecast in the Strategy Plan. The Council also has to comment upon its performance against its Annual Investment Strategy for the year.

2. Recommendations

2.1 That the Members of the Finance and Audit Scrutiny Committee note the contents of this report in respect to this Council's 2014/15 Treasury Management activities.

3. Reasons for the recommendations

3.1 The 2014/15 Treasury Management Strategy and the Council's Treasury Management Practices, in accordance with the Code of Practice for Treasury Management, require that the Treasury Management function reports upon its activities during the year by no later than 30th September in the year after that which is being reported upon.

4. Policy framework

4.1 **Policy Framework** -The Treasury Management function enables the Council to achieve its objectives within the strategy and policies.

4.2 **Fit for the Future** – The Treasury Management function enables the Council to meet its vision of a great place to live work and visit as set out in the Sustainable Community Strategy. Treasury Management will support the Council in achieving its aims as set out in "Fit for the Future".

4.3 **Impact Assessments** – No impacts of new or significant policy changes proposed in respect of Equalities.

5. Budgetary framework

5.1 Treasury Management has a potentially significant impact on the Council's budget through its ability to maximise its investment interest income and minimise borrowing interest payable. The Council is reliant upon interest received to help fund the services it provides. As detailed in paragraph 12.10, the net interest received by the General Fund for 2014/15 was £261,199 against a revised estimate of £239,361 and original of £180,518.

6. Risks

6.1 Investing the Council's funds inevitably creates risk and the Treasury Management function effectively manages this risk through the application of the SLY principle. Security(S) ranks uppermost followed by Liquidity (L) and finally Yield(Y).

6.2 In addition, the introduction, for 2014/15, of Variable Net Asset Money Market Funds into the portfolio potentially increases capital risk through potential capital loss due to market price fluctuations. This is mitigated by good cash flow management ensuring that investments are available for the necessary length of time to ensure that there is no negative impact on the capital value of the fund. In addition, mitigation is achieved by having a lower investment limit than for Constant Net Asset Value Money Market Funds in which there is no risk of capital loss. In 2014/15 the Council invested in the Federated Cash Plus Fund which is a Variable Net Asset Money Market fund and suffered no loss in capital as a result of doing so.

6.3 Corporate Bonds and Floating Rate Notes (FRN's) introduce Counterparty credit risk into the portfolio by virtue of the fact that it is possible that the institution invested in could become bankrupt leading to the loss of all or part of the Council's investment. This is mitigated by only investing in Corporate Bonds or FRN's with a strong Fitch credit rating, in this case A+ and issued as Senior Unsecured debt which ranks above all other debt in the case of a bankruptcy. The Council made no use of these instruments in 2014/15**.**

7 Alternative option considered

7.1 None.

APPENDIX A

2014/15 ANNUAL TREASURY MANAGEMENT REPORT

8. Review of the interest rate environment.

8.1 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.

8.2 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, particularly the heavy "No" vote in the referendum held on 5th July 2015 have increased fears that there is still a chance that Greece will 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 has been disproved with the consequent impact on the EU economy including the UK as a whole. 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. It was expected that 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 the picture has become more complicated since the general election in May 2015 due to concerns about the impact that any referendum on the UK's membership of the EU would have on the potential growth of the economy particularly if the UK votes to leave the EU which accounts for a substantial proportion of the UK export market.

9. Capital expenditure and financing

9.1 The Council's capital programme for 2014/15 amounted to £10,215,880 and was financed in the following manner:-

	2014/15 Actual		Strategy Report
	£		**£**
Prudential Borrowing	0		0
Capital Receipts	1,315,403		2,120,300
Revenue and Reserves	6,639,130		10,031,100
External Contributions and Grants	2,261,347		1,453,500
Total	**10,215,880**		**13,604,900**

10. Borrowing

10.1 The Council managed its cash flow during the year such as to not require any temporary borrowing.

10.2 The Council incurred £4,765,564 interest on its external borrowing portfolio of £136.157 million in 2014/15 which was charged entirely to the HRA as it related to the Self Financing borrowing incurred in 2011/12.

10.3 Interest rates were such during the year that it precluded any opportunity for either the repayment or rescheduling of the PWLB debt.

11. Treasury limits and prudential indicators

11.1 The Prudential Capital Finance system was introduced on 1st April 2004. The system is regulated by a number of Prudential Indicators, a number of which are relevant for treasury management purposes and are included in the Annual Strategy Report. The table overleaf shows the outturn against those quoted in the Strategy Report:-

	2014/15 Out-turn		2014/15 Strategy Report
	£		£
Authorised Limit for External Debt			
Borrowing	162,050,000		165,050,000
Other Long term Liabilities	1,077,000		1,080,000
Total	**163,127,000**		**166,130,000**
Operational Boundary for External Debt			
Borrowing	151,050,000		151,050,000
Other Long term Liabilities	77,000		80,000
Total	**151,127,000**		151,130,000
Capital Financing Requirement			
General Fund	-£1,326,896		-£1,326,896
Housing Revenue Account	£135,786,796		135,786,796
Overall	**£134,459,900**		**£134,459,900**
Incremental Impact on Council Tax / Housing Rents			
Council Tax	£1.29		£3.83
Housing Rent	£0.00		£0.00

11.2 There are the following indicators relating to borrowing:-

Upper limit to fixed interest rate and variable interest rate exposures

Strategy Report - Upper Limit Fixed Rate = 100%
Actual – Upper Limit Fixed Rate = 100%

Strategy Report - Upper Limit Variable Rate = 30%
Actual – Upper Limit Variable Rate = 30%

Upper and lower limits respectively for the maturity structure of borrowing

Period	**Upper**	**Lower**
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%

In both cases the indicators were complied with as the only borrowing outstanding at the year end was the £136.157m PWLB debt in respect of the HRA Self Financing Payment. This debt is all fixed rate maturing from years 41 to 50 of the Business Plan and therefore this is within both indicators shown above.

11.3 The final indicator monitors the amount invested for periods longer than 364 days which in 2014/15 was set at 60% of the investment portfolio subject to a maximum of £15 million at any one time. During 2014/15 the Council entered into three investments for 365 days or over totalling £6m which together with the £7m entered into in 13/14 and which still had 365 days or more to run at 1st April 2014 amounted to a total invested for 365 days or more of £13m. Therefore the indicator was complied with.

12. Annual investment strategy and investment performance

12.1 The Government guidance on local government investments requires the production of an Annual Investment Strategy which amongst other things outlines the investment vehicles which could be used by the Council and separates them off into Specified and Non Specified investments. The 2014/15 Annual Investment Strategy was approved by the Council in March 2014 and can be accessed by clicking on the link in paragraph 1.3.

12.2 During the year the in house investments were invested in the Money Markets and Money Market Funds.

12.3 The in house function has invested the Council's core cash funds in both fixed term Money Market deposits and Certificates of Deposit (CD's). The table below illustrates the performance for the year of the in house function for each category normally invested in (please refer to 2nd half year report for a breakdown by half year):-

(It should be noted that this table reflects investments placed in the year and does not take into account investments that were placed during 2013/14 which matured during 2014/15 and therefore the total interest for 2014/15 does not compare with that shown in paragraph 5.1 which is also net of the amount credited to the Housing Revenue Account in respect of interest earned on its balances).

Money Market (including Certificate of Deposits) Investments:

Period	Investment Return (Annualised)	LIBID Benchmark (Annualised)	Out/(Under) performance
Up to 7 days			
Annual Performance	No investments made in year		
Over 7 days & Up to 3 Months			
Annual Performance	0.48%	0.48%	+0.00%
Annual Interest	£4,756	£4,748	+£8

Period	Investment Return (Annualised)	LIBID Benchmark (Annualised)	Out/(Under) performance
Over 3 Months & Up to 6 Months			
Annual Performance	0.67%	0.62%	+0.05%
Annual Interest	£30,301	£27,721	+£2,580
Over 6 Months to 364 days			
Annual Performance	0.91%	0.93%	-0.02%
Annual Interest	£154,579	£158,179	-£3,600
365 days and over			
Annual Performance	0.98%	1.00%	-0.02%
Annual Interest	£68,663	£70,020	-£1,357
Total Annual Interest – All categories.	**£258,299**	**£260,668**	**-£2,369**

12.4 Due to Money Market Funds outperforming the Up to 7 Day area of the Money Markets, this category was not used in 2014/15.The first half year saw an out performance in the '3 to 6 months' period and marginal underperformance in the 'over 6 months to 364 days' and '365 days and over' periods when compared to the LIBID benchmark plus an enhancement of 0.0625%. During the second half year the outperformance in the '3 to 6 months' period continued and the previous half years underperformance in the '365 days and over' period was converted into an outperformance due to investments placed with a part nationalised bank offering enhanced rates . In the 'over 6 months to 364 days' the in house performance almost precisely matched the enhanced LIBID target for the period.

12.5 The in house function utilised the AAA rated Constant Net Asset Value (CNAV) Invesco AIM, Deutsche, Federated , Ignis and Goldman Sachs Money Market Funds to assist in managing its short term liquidity needs. The table overleaf illustrates the performance of all the funds for the full year:

Money Market Funds:

Fund	Investment Return (Annualised)	LIBID Benchmark (Annualised)	Out/(Under) Performance
Deutsche			
Annual Performance	0.38%	0.42%	-0.04%
Annual Interest	£511	£553	-£42
Goldman Sachs			
Annual Performance	0.41%	0.42%	-0.01%
Annual Interest	£2,473	£2,515	-£42
Invesco Aim			
Annual Performance	0.42%	0.42%	0.00%
Annual Interest	£3,535	£3,468	+£67
Federated Prime Rate Constant Net Asset Value (CNAV)			
Annual Performance	0.48%	0.42%	+0.06%
Annual Interest	£16,559	£14,330	+£2,229
Federated Prime Rate Variable Net Asset Value (VNAV)			
Annual Performance	0.66%	0.62%	+0.04%
Annual Interest	£36,892	£34,288	+£2,604
Ignis			
Annual Performance	0.46%	0.42%	+0.04%
Annual Interest	£39,018	£35,027	+£3,991
TOTAL INTEREST FOR YEAR	**£98,988**	**£90,181**	**+£8,807**

12.6 The Up to 7 Days LIBID rate is the benchmark in this instance and it can be seen that three of the CNAV funds made returns just short of the benchmark. The policy during 2014/15 was to maximise the use of the 2 higher performing CNAV MMF's and as such, at times it was necessary to place funds in the lower performing funds as a result of the counterparty limits on the higher performing funds being reached. Of the lower performing funds, it should be noted that the Deutsche fund was little used during the year with investments being shared between the Goldman Sachs and Invesco Aim funds. The two higher performing CNAV funds made returns in excess of the LIBID benchmark as a result of their having a slightly longer weighted average maturity (WAM) i.e. nearer the 60 day weighted average maximum maturity for CNAV funds.

12.7 Having identified that some of the cash invested in the Federated CNAV MMF was not likely to be required for cash flow purposes for at least 6 months, early in 2014/15 the Council opened up a Variable Net Asset Value (VNAV) Money Market Fund with Federated in order to take advantage of the higher rate of return offered by this vehicle over its CNAV counterpart. Unlike CNAV funds where the capital value is not allowed to fluctuate i.e. for every £ you put in you get a £ back, the capital value in VNAV funds can fluctuate although usually only within a tight band so any potential capital loss is likely to be very limited. For this reason it is necessary to view VNAV funds over a longer time horizon, typically 6 to 9 months, than their CNAV counterparts in order to even out any fluctuations in the capital value and to take advantage of the longer weighted average to maturity (WAM) that VNAV funds are permitted to run. This allows them to invest in longer dated investment vehicles with higher interest rates thus increasing the yield over their CNAV counterparts. In the case of Federated our CNAV fund yielded 0.48% as opposed to the VNAV fund which yielded 0.66%. This perceived greater risk thus yielding a higher return. However, it must be stressed that all Money Market Funds whether CNAV or VNAV have to adhere to a very strict credit rating criteria and therefore funds with slightly more risk in them are still very safe.

12.8 The Council operates two Call accounts with HSBC and Svenska Handelsbanken. In the case of the HSBC account on balances of £2m+ this offers instant access at a rate more or less equivalent to our lower performing CNAV MMF's thus forming a useful addition for investing the Council's cash flow derived money. The Svenska Handelsbanken account is a 35 day notice account currently offering 0.55% which compares favourably with the rate available in the Money Markets for 1 month fixed investments. Because of cash flow demands the HSBC Business Deposit Account underperformed against the LIBID benchmark rate but the Svenska Handelsbanken account compensated by comfortably outperforming the benchmark as can be seen in the table overleaf:

Call Accounts:

Fund	Investment Return (Annualised)	LIBID Benchmark (Annualised)	Out/(Under) Performance
HSBC Business Deposit a/c			
Annual Performance	0.38%	0.42%	-0.04%
Annual Interest	£9,226	£9,949	-£723
Svenska Handelsbanken			
Annual Performance	0.55%	0.42%	+0.13%
Annual Interest	£27,559	£20,527	+£7,032
TOTAL INTEREST FOR YEAR	**£36,785**	**£30,476**	**+£6,309**

12.9 In paragraph 5.1 of the Annual Investment Strategy, the Council anticipated that it would have an average investment balance in the region of £48m during 2014/2015. The actual was £61.5m, the increase being partly accounted for by slippage in the capital programme leading to higher than expected balances in reserves, unused capital receipts and from increased cash flows during the year. In addition the impact of the Housing Self-Financing regime has resulted in increased investment balances both of a cash flow nature and also as a result of the enhanced Capital Programme new build envisaged by the business plan not yet commencing. As an illustration of this the balances on the Major Repairs Reserve and Housing Capital Investment Reserve have increased by £1.8 million and £3.8 million respectively at the end of the year. The investment strategy of this cash would not have been any different had we known about the "additional" £5.6m. Paragraph 5.2 of the Annual Investment Strategy makes reference to a 40% maximum long term investments holding. The average investment balance in 2014/15 was £61.5m of which a maximum of £15m could have been invested for more than 364 days at any one time. In actual fact £13m was invested for more than 364 days which was 21% of the portfolio and therefore the Council did not exceed the 40% limit on longer term investments nor did it contravene the requirement to hold at least 60% of its portfolio in short term (364 days or less) investments. A comparison between 2013/14 actual, 2014/15 latest and 2014/15 actual in terms of in house investment interest returns and interest rates is shown in the table below:-

In House Investment Returns:

Year	Interest Received (£)	Interest Rate Achieved %
2013/14 actual	367,931	0.69
2014/15 latest	396,412	0.70
2014/15 actual	428,145	0.70

In the Annual Investment Strategy approved in March 2014, it was anticipated that the in house portfolio would achieve a 0.64% return for 2014/15. The actual rate was 0.70% which is identical to the 2014/15 revised.

12.10 The table below compares the actual total interest received by the Council with what was expected when the original and latest estimates were calculated and also the 2013/14 actual:-

	Credited to General Fund	**Credited to Housing Revenue Account**	**Total Investment Interest Earned**
	£	**£**	**£**
2013/14 Actual	242,387	131,700	374,087
2014/15 Original	180,518	137,600	318,118
2014/15 Latest	239,361	167,500	406,861
2014/15 Actual	261,199	178,300	439,499

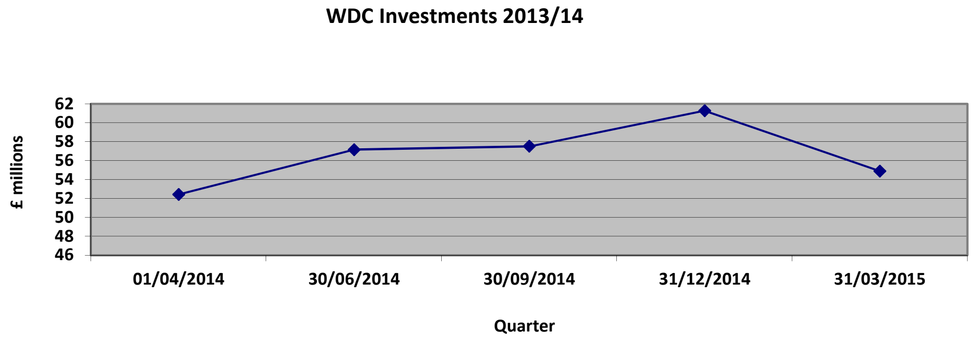
It should be borne in mind that the 2013/14 and 2014/15 actual figures in the tables in 12.9 and 12.10 are not directly comparable as the table in 12.9 relates only to investments made whilst the figures in 12.10 include interest received from other sources i.e. car loans, long term investments e.g. war stock and deferred capital receipts.

12.11 An analysis of the overall investments of the Council as at 31st March 2015 is shown in the table below, with the previous year's figures shown for comparison purposes:

IN HOUSE	**31st March 2015**	**31st March 2014**
TYPE OF INVESTMENT	**£**	**£**
Money Markets inc. CD's	32,075,768	34,010,804
Call Accounts	7,278,000	5,739,000
Money Market Funds	15,541,000	12,671,000
Total	**54,894,768**	**52,420,804**

It should be noted that the Money Markets figure at 31st March 2015 includes £75,768 capital appreciation as a result of the price for each CD at 31st March being greater than that which was paid when the CD was originally purchased. However, these CD's were purchased on a "buy to hold" basis and thus this capital appreciation will not be realised when the CD's mature as they will be redeemed at "par" i.e. the original price.

12.12 The graph overleaf shows how the total of the Council's investments varies through the year according to its cash flows. It illustrates that during the period April to December the Council's investments grows as cash flows in from such sources as Council Tax & NNDR and then from January onwards how the investments decline as cash flows out e.g. precepts exceed that coming in.



13. Performance measurement

13.1 In addition to the in house local benchmarks referred to in the tables in paragraphs 12.3, 12.5 and 12.8 the Council participates in the Capita Asset Services Investment Benchmarking Club which benchmarks not only investment returns but also the maturity and credit risk inherent in the portfolio. The Council is part of a local group which consists of District and County Councils and our performance over the past year is reflected in the tables below:-

Table A Weighted Average Rate of Return (WARoR)

	WDC WARoR %	Local Group WARoR %	Capita Asset Services Model WARoR %
June Quarter	0.70	0.62	0.71
September Quarter	0.70	0.67	0.70
December Quarter	0.71	0.66	0.70
March Quarter	0.77	0.69	0.75
Average for Year	**0.72**	**0.66**	**0.72**

(n.b. it should be noted that the average interest rate for the year is not directly comparable to that quoted in paragraph 12.9 as that contains the effect of investments made in 2013/14 and maturing in 2014/15 whereas the rate in table A relates to 2014/15 investments only.)

13.2 It can be seen that the Council's average return was in line with the Capita Asset Services' model portfolio rate of return based on the risk in our portfolio. The Council's average for the year outperformed against the local group's rate of return mainly due to the local group having a greater proportion of their investments in the relatively short end of the market of up to 6 months, on average 88% of their portfolio compared with WDC's 68%.As a consequence the local group were not able to benefit from the more attractive rates being offered for longer term investments particularly of 364 day duration by the likes of Lloyds Banking Group. This Council took the view that with short term rates unlikely to move much away from the Bank Rate of 0.50% benefit was to be had from investing in longer term investments in order to increase the yield in the portfolio without materially affecting the security of the portfolio. This was achieved by investing with Lloyds Banking Group and Royal Bank of Scotland both of whom are part owned by the UK Government and by purchasing certificates of deposits from highly credit rated counterparties.

Table B Weighted Average Credit Risk

	WDC	Local Group
June Quarter	2.6	2.9
September Quarter	2.3	2.8
December Quarter	2.6	2.6
March Quarter	2.4	2.7
Average for Year	**2.5**	**2.8**

13.3 This benchmark measures the average credit risk in the portfolio according to the institutions invested in and corresponds to the duration limits in Capita Asset Services' suggested credit methodology using a sliding scale of 1 to 7 where 1 indicates the least risk of default. The above table shows that this Council's credit risk during the year had a level below that of the local group and analysis of the data indicates that for three quarters of the year this was due to this Council having a greater amount of its portfolio invested in highly rated counterparties such as part nationalised UK banks e.g. Lloyds and RBS and triple A rated Money Market Funds than the local group. The Council also did not have any investments with Building Societies as opposed to the local group which between them had 8% to 10% of their portfolio's invested with these institutions. In general Building Societies have lower credit ratings or indeed are unrated which in the Capita Benchmarking model attracts a greater credit risk factor.

14. The Euro

14.1 The Treasury Management Strategy Plan requires the Treasury Management function to keep up to date with matters relating to the UK's possible entry into the Euro. A number of factors such as the fact that a) the Eurozone faces the likelihood of weak growth over the next few years b) the current crisis concerning Greece's position within the Eurozone and c) the potential referendum on the UK's membership of the EC make it extremely unlikely that the UK will consider joining the Eurozone for the foreseeable future.

15. External treasury management advisers

15.1 Capita Asset Services continues to provide our Treasury Management Advisory service. Following the requisite procurement exercise, the contract was renewed in January 2015 for a further three years with a provision to extend for another 2 years.

16. Other issues

16.1 The Council has entered into a joint venture with Waterloo Housing Association in which Council land will be sold on a deferred basis to the Housing Association in order to provide resources for additional social housing. The first parcel of land, the former Kingsway Community Centre, was sold during 2012/13 to Waterloo HA which resulted in a deferred capital receipt of £224,252. During 2014/15, further sales to Waterloo of WDC land comprising two garage sites at Bourton Drive and Henley Road and a site at the rear of Market Street in Warwick took place resulting in additional deferred capital receipts of £564,225 which again will not be available for use until the final instalment payment is received some years in the future.