WARWICK DISTRICT COUNCIL	**Finance and Audit Scrutiny Committee** **28th June 2016.**	**Agenda Item No. 3**

Title	2015/16 Annual Treasury Management Report
For further information about this report please contact	Karen Allison, Assistant Accountant 01926 456334 Roger Wyton, Principal Accountant 01926 456801 e mail: karen.allison@warwickdc.gov.uk e mail: roger.wyton@warwickdc.gov.uk
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Is the report private and confidential and not for publication by virtue of a paragraph of schedule 12A of the Local Government Act 1972, following the Local Government (Access to Information) (Variation) Order 2006	No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 2015/2016 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	15/06/2016	Andrew Jones
Head of Service	N/A	
CMT	N/A	
Section 151 Officer	15/06/2016	Mike Snow
Monitoring Officer	N/A	
Finance	13/06/2016	Roger Wyton
Portfolio Holder(s)		Peter Whiting

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 2015/16 Treasury Management performance by 30th September. This report therefore details and reviews the Council's performance for the whole of 2015/16 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 11th February 2015 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 2015/16 Treasury Management activities.

3. Reasons for the recommendations

3.1 The 2015/16 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 12.8, the net interest received by the General Fund for 2015/16 was £303,200 against a revised estimate of £297,420 and original of £261,199.

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 The Council invested in Corporate Bonds in 2015/16 which introduced Counterparty credit risk into the portfolio by virtue of the fact that it was possible that the institution invested in could have become bankrupt leading to the loss of all or part of the Council's investment. This was mitigated by only investing in Corporate Bonds with a strong Fitch credit rating, in this case A+ and issued as Senior Unsecured debt which ranked above all other debt in the case of a bankruptcy. No such capital loss was incurred in 2015/16.

7 Alternative option considered

7.1 None.

APPENDIX A

2015/16 ANNUAL TREASURY MANAGEMENT REPORT

8. Review of the interest rate environment.

8.1 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.

8.2 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 the UK surged strongly during both 2013/14 and 2014/15 to make the UK the top performing advanced economy in 2014. However, 2015 has been disappointing with growth falling steadily from an annual rate of 2.9% in quarter 1 2015 to 2.1% in quarter 4.

8.3 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.

9. Capital expenditure and financing

9.1 The Council's capital programme for 2015/16 amounted to £14,791,000 and was financed in the following manner:-

	2015/16 Actual		Strategy Report
	£		£
Loan/Internal Borrowing	111,445		0
Capital Receipts	2,140,664		1,454,800
Revenue and Reserves	11,891,888		17,504,700
External Contributions and Grants	647,221		979,100
Total	**14,791,218**		**19,938,600**

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 2015/16 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 below shows the outturn against those quoted in the Strategy Report:-

	2015/16 Out-turn		2015/16 Strategy Report
	£		£
Authorised Limit for External Debt			
Borrowing	160,050,000		184,050,000
Other Long term Liabilities	1,045,000		1,045,000
Total	**161,127,000**		**185,095,000**
Operational Boundary for External Debt			
Borrowing	151,050,000		151,050,000
Other Long term Liabilities	45,000		45,000
Total	**151,127,000**		151,095,000
Capital Financing Requirement			
General Fund	-£1,215,451		-£1,326,896
Housing Revenue Account	£135,786,796		135,786,796
Overall	**£134,571,345**		**£134,459,900**
Incremental Impact on Council Tax / Housing Rents			
Council Tax	£1.31		£3.83
Housing Rent	£0.18		£0.51

The incremental impact on Council Tax and Housing Rents out-turn was lower than the expected figure due to slippage in the capital programme resulting in increased balances available for investment.

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 external 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 2015/16 was set at 60% of the investment portfolio subject to a maximum of £15 million at any one time. During 2015/16 the Council entered into one investment for 365 days or over totalling £3m which confirms that 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 2015/16 Annual Investment Strategy was approved by the Council in February 2015.

12.2 The in house function has invested the Council's cash funds in fixed term Money Market deposits, Corporate Bonds, Certificates of Deposit (CD's) and Money Market Funds. 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 2014/15 which matured during 2015/16 and therefore the total interest for 2015/16 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 and Bonds) 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	No investments made in year		
Over 3 Months & Up to 6 Months			
Annual Performance	0.65%	0.67%	-0.02%
Annual Interest	£49,976	£48,336	-£1,360
Over 6 Months to 364 days			
Annual Performance	0.90%	0.82%	+0.08%
Annual Interest	£218,681	£198,658	+£20,023
365 days and over			
Annual Performance	1.00%	0.96%	+0.04%
Annual Interest	£30,247	£29,173	+£1,074
Total Annual Interest – All categories.	**£295,903**	**£276,183**	**+£19,719**

12.3 Due to Money Market Funds outperforming the Up to 7 Day area of the Money Markets, this category was not used in 2015/16 .The first half year saw an out performance in the '3 to 6 months' and '365 days and over' periods and an underperformance in the 'over 6 months to 364 days', when compared to the LIBID benchmark plus an enhancement of 0.0625%. During the second half year investments made in the '3 months to 6 months' period resulted in an underperformance. However, in the '6 months to 365 days' period a significant out performance resulted from CD and fixed deposit investments.

12.4 The in house function utilised the AAA rated Constant Net Asset Value (CNAV) Invesco AIM, Deutsche, Federated, Ignis and Goldman Sachs Money Market Funds and Variable Net Asset Value (VNAV) Federated and Royal London Asset Management Funds to assist in managing its short term liquidity needs. The table below 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	0.45%	0.42%	+0.03%
Annual Interest	£7,498	£7,081	+£417
Goldman Sachs			
Annual Performance	0.44%	0.42%	+0.02%
Annual Interest	£18,029	£17,469	+£560
Invesco Aim			
Annual Performance	0.47%	0.42%	+0.05%
Annual Interest	£15,558	£13,969	+£1,589
Federated Prime Rate Constant Net Asset Value (CNAV)			
Annual Performance	0.53%	0.42%	+0.11%
Annual Interest	£25,020	£19,839	+£5,181
Federated Prime Rate Variable Net Asset Value (VNAV)			
Annual Performance	0.68%	0.68%	+0.00%
Annual Interest	£29,525	£33,141	-£3,616
Standard Life (was Ignis)			
Annual Performance	0.49%	0.42%	+0.07%
Annual Interest	£43,740	£37,833	+£5,907
Royal London Cash Plus Account (VNAV)			
Annual Performance	0.58%	0.67%	-0.09%
Annual Interest	£11,310	£10,795	+£515
TOTAL INTEREST FOR YEAR	**£150,680**	**£139,354**	**+£11,326**

12.5 The Up to 7 Days LIBID rate is the benchmark for the CNAV funds and it can be seen that they all made returns in excess of this. The two VNAV fund benchmarks are based on the 6 month LIBID rate (plus a margin of 0.0625%) and the returns include fees and so are not directly comparable with the benchmark.

12.6 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 3 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 below:

Call Accounts:

Fund	Investment Return (Annualised)	LIBID Benchmark (Annualised)	Out/(Under) Performance
HSBC Business Deposit a/c			
Annual Performance	0.36%	0.42%	-0.06%
Annual Interest	£4,972	£5,790	-£818
Svenska Handelsbanken			
Annual Performance	0.55%	0.45%	+0.10%
Annual Interest	£27,671	£22,400	+£5,271
TOTAL INTEREST FOR YEAR	**£32,643**	**£28,190**	**+£4,453**

12.7 In paragraph 3.1 of the Annual Investment Strategy, the Council anticipated that it would have an average investment balance in the region of £50m during 2015/2016. The actual was £70.6m and the main increases are broken down below:-

General Fund Provision & Reserves	+£6,600
Major Repairs Allowance Reserve	+£3,800
Housing Capital investment Reserve	+£6,000
Capital Receipts	+£4,300

These increases are partly accounted for by slippage in the revenue and capital programmes leading to higher than expected balances in reserves, unused capital receipts and from increased cash flows during the year. As an illustration, 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. The investment strategy of this cash would not have been any different had we known about the "additional" £20.6m. Paragraph 5.2 of the Annual Investment Strategy makes reference to a 60% maximum long term investments holding. The average investment balance in 2015/16 was £70.6m of which a maximum of £42m could have been invested for more than 364 days at any one time. In actual fact £3m was invested for more than 364 days which was 4.25% of the portfolio and therefore the Council did not exceed the 60% limit on longer term investments nor did it contravene the requirement to hold at least 40% of its portfolio in short term (364 days or less) investments. A comparison between 2014/15 actual, 2015/16 latest and 2015/16 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 %
2014/15 actual	428,847	0.70
2015/16 latest	443,388	0.70
2015/16 actual	481,812	0.68

In the Annual Investment Strategy approved in February 2015, it was anticipated that the in house portfolio would achieve a 0.80% return for 2015/16. The actual rate was 0.68% which is close to the 2015/16 revised.

12.8 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 2014/15 actual:-

	Credited to General Fund	Credited to Housing Revenue Account	Total Investment Interest Earned
	£	£	£
2014/15 Actual	261,199	178,300	439,499
2015/16 Original	291,889	132,100	423,989
2015/16 Latest	297,420	172,200	469,620
2015/16 Actual	303,200	198,600	501,800

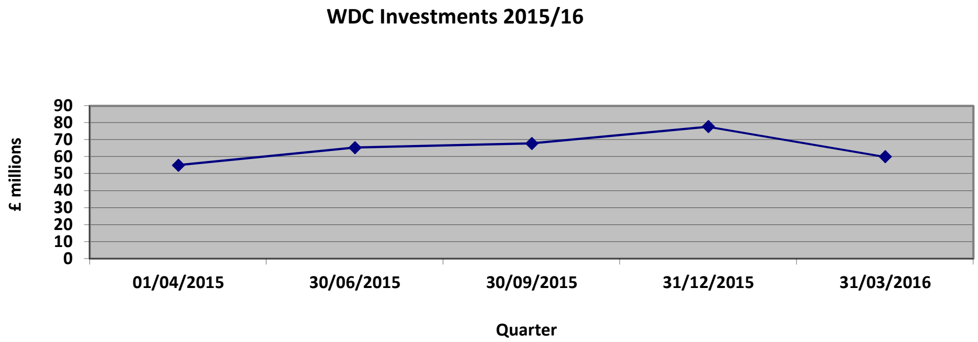
It should be borne in mind that the 2014/15 and 2015/16 actual figures in the tables in 12.7 and 12.8 are not directly comparable as the table in 12.7 relates only to investments made whilst the figures in 12.8 include interest received from other sources i.e. car loans, long term investments e.g. war stock and deferred capital receipts.

12.9 An analysis of the overall investments of the Council as at 31st March 2016 is shown in the table overleaf, with the previous year's figures shown for comparison purposes:

IN HOUSE	31st March 2016	31st March 2015
TYPE OF INVESTMENT	**£**	**£**
Money Markets inc. CD's & bonds	31,259,255	32,075,768
Call Accounts	5,046,000	7,278,000
Money Market Funds	23,679,000	15,541,000
Total	**59,998,255**	**54,894,768**

It should be noted that the Money Markets figure at 31st March 2016 includes £59,255 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.

12.10 The graph below 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. <u>Performance measurement</u>

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 overleaf:-

Table A Weighted Average Rate of Return (WARoR)

	WDC WARoR %	**Local Group WARoR %**	**Capita Asset Services Model WARoR %**
June Quarter	0.71	0.64	0.70
September Quarter	0.70	0.65	0.73
December Quarter	0.65	0.62	0.59
March Quarter	0.73	0.68	0.68
Average for Year	**0.70**	**0.65**	**0.68**

(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 2014/15 and maturing in 2015/16 whereas the rate in table A relates to 2015/16 investments only.)

13.2 It can be seen that the Council's average return was marginally above Capita Asset Services' model portfolio rate of return and also the local group's based on the risk in our portfolio.

Table B Weighted Average Credit Risk

	WDC	**Local Group**
June Quarter	2.5	2.9
September Quarter	2.6	3.3
December Quarter	2.7	3.0
March Quarter	3.2	3.3
Average for Year	**2.8**	**3.1**

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 marginally below that of the local group and this in part stems from the Council taking advantage of special tranche rates issued by Lloyds Bank, a highly rated counterparty, which also contributed to the outperformance in respect of the rate of return.

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. The current economic situation both in the UK and the Eurozone makes it extremely unlikely that the UK will be joining the Eurozone for the foreseeable future whatever the outcome of the referendum on 23rd June.

15. External treasury management advisers

15.1 Capita Asset Services continues to provide our Treasury Management Advisory service.

16. Other issues

16.1 None.