APPENDIX A

Annual Treasury Management Report 2015/16

as at 27/5/16 - LT

East Staffordshire Borough Council

1. Introduction and Background

This Council is required through regulations issued under the Local Government Act 2003 to produce an annual treasury report reviewing treasury management 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 Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council - February 2015)
- a mid year (minimum) treasury update report (Council – December 2015)
- an annual report following the year describing the activity compared to the strategy (this report)

In addition, the Cabinet has received quarterly treasury management updates as part of the overall financial reporting during the course of the year.

The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is 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 members.

This Council also confirms that it has complied with the requirement under the Code to give prior scrutiny of treasury management reports by the Audit Committee before they were reported to the full Council. Member training on treasury management issues was undertaken during the year in order to support members' scrutiny role.

2. This Annual Treasury Report Covers

- the council's treasury position as at 31 March 2016;
- the strategy for 2015-16 – a summary;
- Borrowing and Investments outturn
- the economy and interest rates in 2015-16;
- compliance with treasury limits and prudential indicators;
- Icelandic bank defaults and other issues.

3. Treasury Position as at 31 March 2016

The council's debt and investment portfolio is organized by the financial management service in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks with all treasury management activities. Procedures and controls to achieve these objectives are well established through member reporting detailed in the introduction, and through officer activity detailed in the council's treasury Management practices.

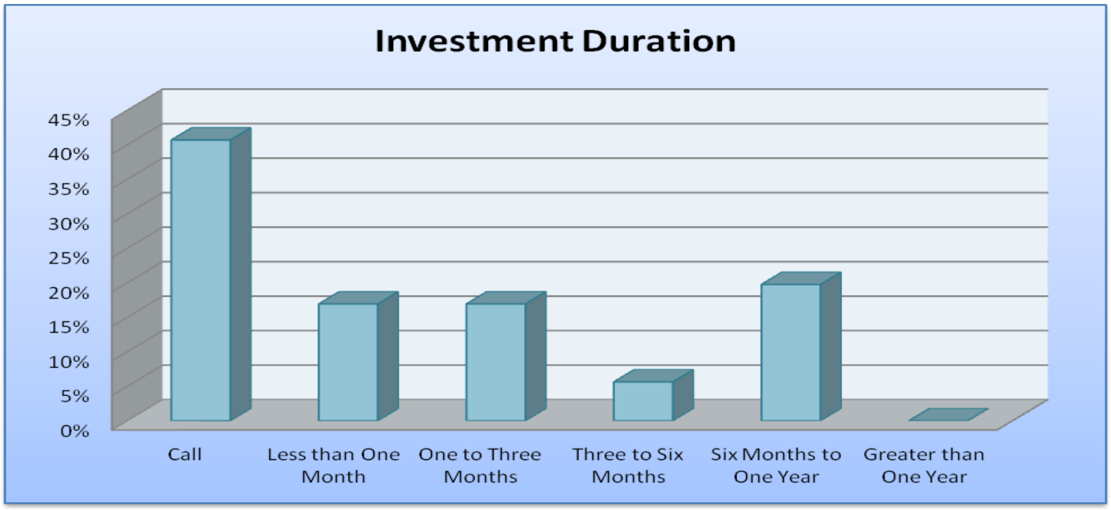
The council's treasury portfolio position (excluding borrowing from finance leases) and the average interest rates on the portfolio as at the beginning and end of the year were as follows:

2014/15 Principal	Average Rate		2015/16 Principal	Average Rate
		Borrowing		
£6.6m		- PWLB	£6.5m	
£5.0m		- Market and other	£5.0m	
£11.6m	**5.4%**	**Total Borrowing**	**£11.5m**	**5.4%**
		Investments		
£12.5m	**0.7%**	Core Deposits	£17.8m	**0.7%**
£0.1m		Icelandic Investments (impaired)	-	
-		Cash and Bank	(£0.5m)	
£12.6m		**Total Investments**	**£17.3m**	

The maturity structure of the **borrowing** was as follows:-

2014/15 Principal		2015/16 Principal
£0.3m	Under 1 Year	**£0.6m**
£0.4m	Maturing in 1-2 Years	**£0m**
£0.2m	Maturing in 2-5 Years	**£0.2m**
£0.3m	Maturing in 5-10 Years	**£6.9m**
£6.8m	Maturing in 10-15 Years	**£3.8m**
£3.6m	Maturing in excess of 15 Years	**£0m**
£11.6m	**Total**	**£11.5m**

The maturity structure of the **investments at 31st March** was as follows:-



4. The Strategy for 2015-16 - Summary

The Treasury Management Strategy Statement and Annual Investment Strategy for 2015/16 was approved by the Council on 23rd February 2015.

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 was to operate a under borrowed or internally borrowed position, postponing external 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. Borrowing Outturn for 2015/16

5.1 Capital Financing Requirement

The councils 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. It represents unfinanced capital expenditure as at the year end.

The council's CFR is not allowed to rise indefinitely. Statutory controls are in place that require the authority to make an annual revenue charge, called the Minimum Revenue Provision (MRP) to reduce the CFR. This is effectively a repayment of non-housing borrowing.

The council's 2015/16 MRP policy (as required by CLG guidance) was approved as part of the Treasury Management Strategy Statement for 2015/16.
The CFR position is set out in the table below:-

CFR	2015/16 Actual £'000	2014/15 Actual £'000
Opening Balance	**20,744**	**20,988**
Add unfinanced capital expenditure	**2,885**	**582**
Less MRP	**(509)**	**(472)**
Less Debt Repayment	**(1,540)**	**-**
Less finance lease repayments	**(664)**	**(314)**
Change in long term debtors	**(95)**	**(40)**
Closing Balance	**20,821**	**20,744**

The strategy estimated that the CFR would be £18.9m as at 31st March 2016. The increase relates to Waste Vehicles that have been classified as finance leases, which is a technical accounting issue. At the time the strategy was approved the arrangements for replacing the vehicles could not be reliably predicted, nevertheless headroom has been allowed for in setting our borrowing limits and therefore we have operated within the overall approved strategy.

Unfinanced capital expenditure relates in the main Waste Vehicles acquired through finance leases (£2.6m), plus £0.285m in relation to the remediation works at Dove Way, which is being financed via a loan from the GBSLEP. This increase is largely offset by in year statutory repayments and the decision to repay £1.540m of debt in relation to the cost of refurbishing Burton Market Hall. The net impact is a small increase in the overall underlying need to borrow.

The Council's borrowing activity is constrained by affordability, and prudential indicators including the CFR, operational boundary and the authorised limit.

5.2 The Authorised Limit and Operational Boundary

The authorised limit is the "affordable borrowing limit" required by Section 3 of the Local Government Act 2003. 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 is the expected borrowing position of the council during the year. Periods where the actual position is either above or below the boundary are acceptable subject to the authorised limit not being breached. The level is set at £21.5m to allow some headroom.

2014/15 £'000	Borrowing Limits and Boundaries	2015/16 £'000
23,500	Authorised Limit	**23,500**
21,500	Operational Boundary	**21,500**
12,122	Gross Borrowing at 31st March (inc, Finance Leases)	**13,958**
11,598	Gross Borrowing at 31st March (excl. Finance leases)	**11,527**
20,744	Capital Financing Requirement	**20,821**

5.3 Short-term Borrowing

It was anticipated that only very limited short-term borrowing (less than 5 days) would be required to cover temporary cash flow deficits; interest payable would therefore be minimal. No short term borrowing has been necessary during 2015/16.

5.4 Debt Re-scheduling

Debt rescheduling opportunities have been limited in the current economic climate and consequent structure of interest rates. There has not been any restructuring undertaken during 2015/16.

6. Investments Outturn 2015/16

6.1 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 February 2015. The policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit agencies supplemented by additional market data (such as credit outlooks, credit default swaps, bank share prices).

The investment activity during the year conformed with the approved strategy, and the Council had no liquidity difficulties.

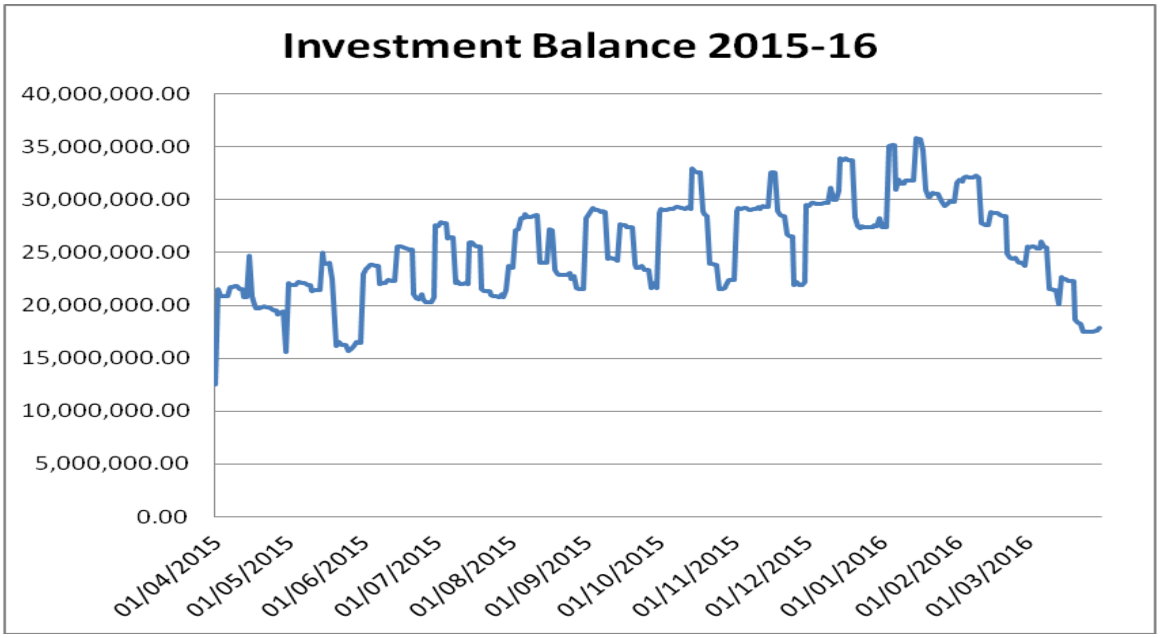
6.2 Investments as at 31st March 2016

The Council's core investments during 2015/16 have increased to £18m. These balances were, in the main, held within AAA rated Money Market Funds and fixed term deposits amounting to £6m have also been placed with a few UK Banks offering rates above those provided by the business reserve accounts. This strategy reflects a continuation of the council's relatively low risk appetite in relation to its investments, but also the limited availability of attractive fixed term rates with suitable counterparties in the current economic climate.

The Council's Investments as at 31st March 2016 were:

Borrower	Principal (£)	Interest Rate	Start Date	Maturity Date
Call/Notice Accounts and Money Market Funds				
RBS SIBA	627,592	0.25%		
Barclays	1,880,789	0.45%		
Prime Rate MMF	700,000	0.48%		
Insight MMF	4,000,000	0.52%		
Santander (notice)	3,500,000	0.90%		
Lloyds (notice)	1,000,000	0.80%		
Fixed Deposits:				
Barclays	1,500,000	0.68%	19/11/2015	19/05/2016
Bank of Scotland	1,500,000	1.00%	02/04/2015	01/04/2016
Bank of Scotland	500,000	0.75%	04/11/2015	04/05/2016
Lloyds	1,000,000	0.75%	01/12/2015	01/06/2016
Lloyds	1,500,000	1.00%	02/04/2015	01/04/2016

The chart below illustrates the movement in the level of investments held by the Council throughout the year, with the peak being £35.7m in January and the average being £25m.



6.3 Investment Rates

The following table illustrates the rate of return generated by the council's Investments for 2015/16, which compares favourably with the benchmark returns:

	Average Rate Year to 31/03/16
ESBC	0.69%
7 day LIBID Rate	0.36%
3 Month LIBID Rate	0.46%
Base Rate	0.50%
Budget	0.70%

**LIBID = London Inter Bank Deposit Rate

The ESBC average return for the year exceeds the base rate and other benchmarks. This is an extremely favourable outcome considering the portfolio risk score has been consistently within the average of our local benchmarking group throughout the year.

7. 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.

8. Compliance with Treasury Limits

As set out in Appendix 1, a number of indicators have exceeded the original estimate set out within the Strategy. This is due to new waste vehicles acquired during the course of the year, which have subsequently been classified as finance leases. This would have been very difficult to predict when the strategy was set. Nevertheless the approved strategy does allow headroom within our borrowing limits for such an occurrence, as a result our borrowing remains within the overall approved limits. The outturn for the Prudential Indicators *is shown in Appendix 1.*

9. Icelandic Bank Defaults

This authority currently has the following investments outstanding in Icelandic banks:

Borrower - Icelandic Exposure	Principal (£)	Interest Rate	Start Date	Maturity Date
Singer	325,000	5.41%		08/10/2008

The administrators for Kaupthing, Singer and Friedlander Ltd made one dividend payment during the financial year. It is currently anticipated that the administration process will continue into 2017.

Appendix 1: Prudential Indicators

PRUDENTIAL INDICATOR	2014/15	2015/16	2015/16
	£'000	£'000	£'000
	actual outturn	Original Estimate	actual outturn
Capital Expenditure	**5,617**	**2,719**	**5,697***
Ratio of financing costs to net revenue stream	**10.36%**	**11.48%**	**11.70%**
Capital Financing Requirement as at 31 March	**20,744**	**18,938**	**20,821***
External Debt (inc. Finance leases)	**12,122**	**11,456**	**13,958***
Incremental impact of capital investment decisions	**£ p**	**£ p**	**£ p**
Increase in Council Tax (band D) per annum	**0.06**	**0.11**	**0.10**

*largely related to the impact of new finance leases.

PRUDENTIAL INDICATOR	2014/15	2015/16	2015/16
(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	**£'000**	**£'000**	**£'000**
	actual outturn	**original**	**actual outturn**
Authorised Limit for external debt -			
borrowing	**21,500**	21,500	**21,500**
other long term liabilities*	**2,000**	2,000	**2,000**
TOTAL	**23,500**	**23,500**	**23,500**
Operational Boundary for external debt -			
Borrowing	**19,500**	19,500	**19,500**
other long term liabilities*	**2,000**	2,000	**2,000**
TOTAL	**21,500**	**21,500**	**21,500**
Upper limit for fixed rate exposure	9,000	9,000	**9,000**
Upper limit for variable rate exposure	4,000	4,000	**4,000**
Upper limit for total principal sums invested for over 1 year	2,500	3,000	**3,000**

*This provides an allowance for on-balance sheet finance leases, as set out in previous reports.

Maturity structure of new fixed rate borrowing during 2015/16	upper limit	lower limit
under 12 months	85%	0%
12 months and within 24 months	85%	0%
24 months and within 5 years	85%	0%
5 years and within 10 years	90%	0%
10 years and above	95%	0%