ARGYLL AND BUTE COUNCIL	**COUNCIL**
STRATEGIC FINANCE	**25 JUNE 2015**

Annual Treasury Report 2014-15

1. EXECUTIVE SUMMARY

1.1 This report outlines the Council's Treasury Management position for 2014-15.

1.2 The Council is required by regulations issued under the Local Government in Scotland Act 2003 to produce an annual review of treasury management activities and the actual prudential and treasury indicators and submit this to Council. The report at Appendix 1 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.

1.3 The report was submitted to the Performance Review and Scrutiny Committee on 28 May 2015. The Performance Review and Scrutiny Committee has a role to scrutinise treasury matters. No matters were identified that required to be brought to the Councils attention. There are some minor changes to the final report to reflect matters arising in completing the Councils unaudited accounts.

1.4 The key points to note from the annual report are:

- Reporting requirements under the Code were met during 2014-15.
- Borrowing increased from 31 March 2013 at £161m to £173m with an average rate of 5.4%.
- The Capital Financing Requirement (excluding NPDO commitments) was £180m leading to under borrowing of £6m (down from £15m).
- Investments at 31 March 2015 were £56m at a rate of 0.647% compared to £44m at a rate of 0.765% for 31 March 2014.
- The average investment rate for 2014-15 was 0.692% compared to the average 7 day rate of 0.352%

1.5 This report meets the Code requirement for a treasury annual report. The Council remains under borrowed (around 3% of the CFR is not supported by borrowing) but current borrowing and investment rates mean additional costs would be incurred to address this. No significant new borrowing took place during the year and whilst investment rates are low we exceeded our benchmark.

2. RECOMMENDATIONS

2.1 The Treasury Management Annual Report is approved.

3. IMPLICATIONS

3.1 Policy – None

3.2 Legal – None

3.3 Human Resources – None

3.4 Financial – None

3.5 Equal Opportunities – None

3.6 Risk – None

3.7 Customer Service – None

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Appendix 1 – Annual Treasury Report 2014-15

Appendix 1

ANNUAL TREASURY REPORT

2014-2015

Annual Treasury Management Review 2014/15

1. Introduction

This Council is required by regulations issued under the Local Government in Scotland Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2014/15. 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 2014/15 the minimum reporting requirements were that the full Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 20/03/2014)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

In addition the Policy and Resources Committee has received treasury management update reports on 28/08/2014, 20/11/2014, 18/12/2014, 26/02/2015 and 19/03/2015.

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 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 to all of the above treasury management reports by the Policy Review and Scrutiny Committee before they were reported to the Policy and Resources Committee and full Council .

2. The Economy and Interest Rates

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.

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 have increased fears that Greece could be heading for an 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 had been disproved. 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. 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, there was also an increase in concerns around political risk from the general election due in May 2015.

3. Overall Treasury Position as at 31 March 2015

At the beginning and the end of 2014/15 the Council‘s treasury (excluding borrowing by PFI and finance leases) position was as follows:

TABLE 1	31 March 2014 Principal	Rate/ Return	Average Life yrs	31 March 2015 Principal		Rate/ Return	Average Life yrs
Total debt	***£161m***	***6.1%***	***30.18***		***£173m***	***5.4%***	***29.18***
CFR	***£176m***				***£180m***		
Over / (under) borrowing	***£15m***				***£6m***		
Total investments	***£44m***	***0.8%***			***£56m***	***0.7%***	
Net debt	**£117m**				**£117m**		

4. The Strategy for 2014/15

The expectation for interest rates within the strategy for 2014/15 anticipated low but rising Bank Rate (starting in quarter 1 of 2015), and gradual rises in medium and longer term fixed borrowing rates during 2014/15. 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 postpone borrowing to avoid the cost of holding higher levels of investments and to reduce counterparty risk.

The actual movement in gilt yields meant that PWLB rates saw little overall change during the first four months of the year but there was then a downward trend for the rest of the year with a partial reversal during February.

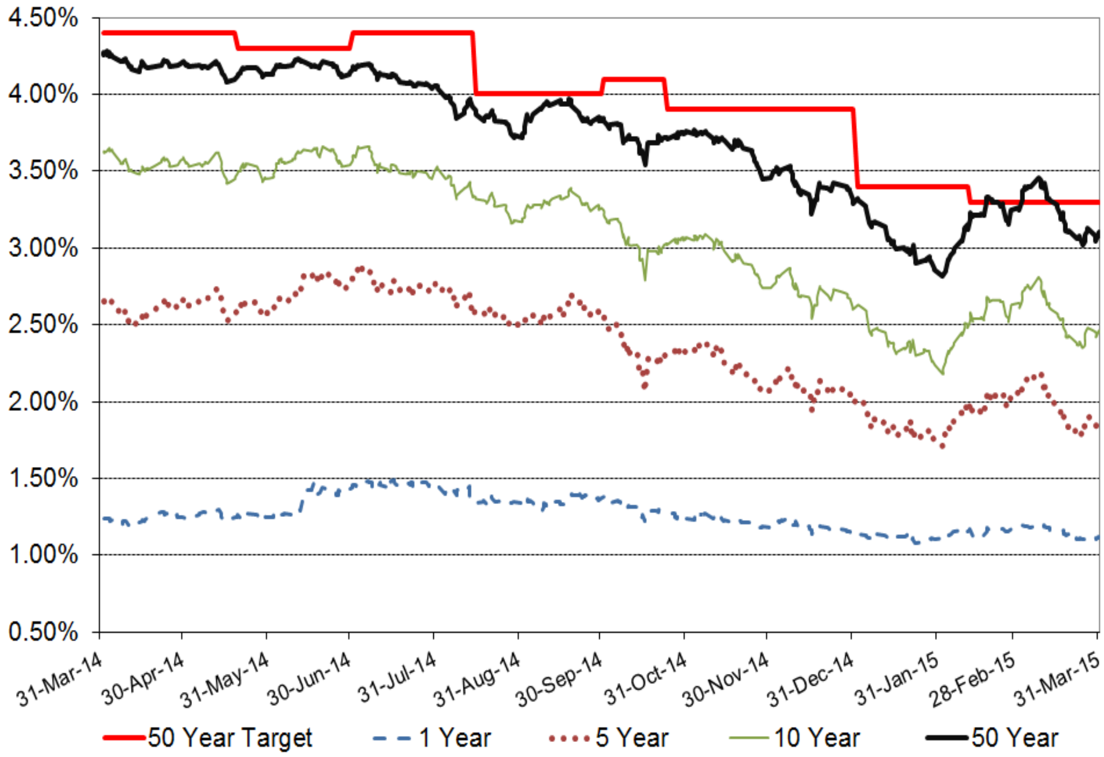
5. The Borrowing Requirement and Debt

The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).

	31st March 2014 Actuals £M	**31st March 2015 Budget £M**	**31st March 2015 Actuals £M**
CFR - General Fund (£m)	256	259	256
Less NPDO	80	77	76
Net CFR	176	182	180

6. Borrowing Rates in 2014/15

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 2014/15

Borrowing

Due to investment concerns, both counterparty risk and low investment returns, no long term borrowing was undertaken during the year. However, temporary borrowing has been utilised to manage timing differences between cash requirements and the maturating fixed term investments. At year end there were two fixed term temporary loans of £10m at an average rate of 0.34% outstanding.

Repayment of Loans

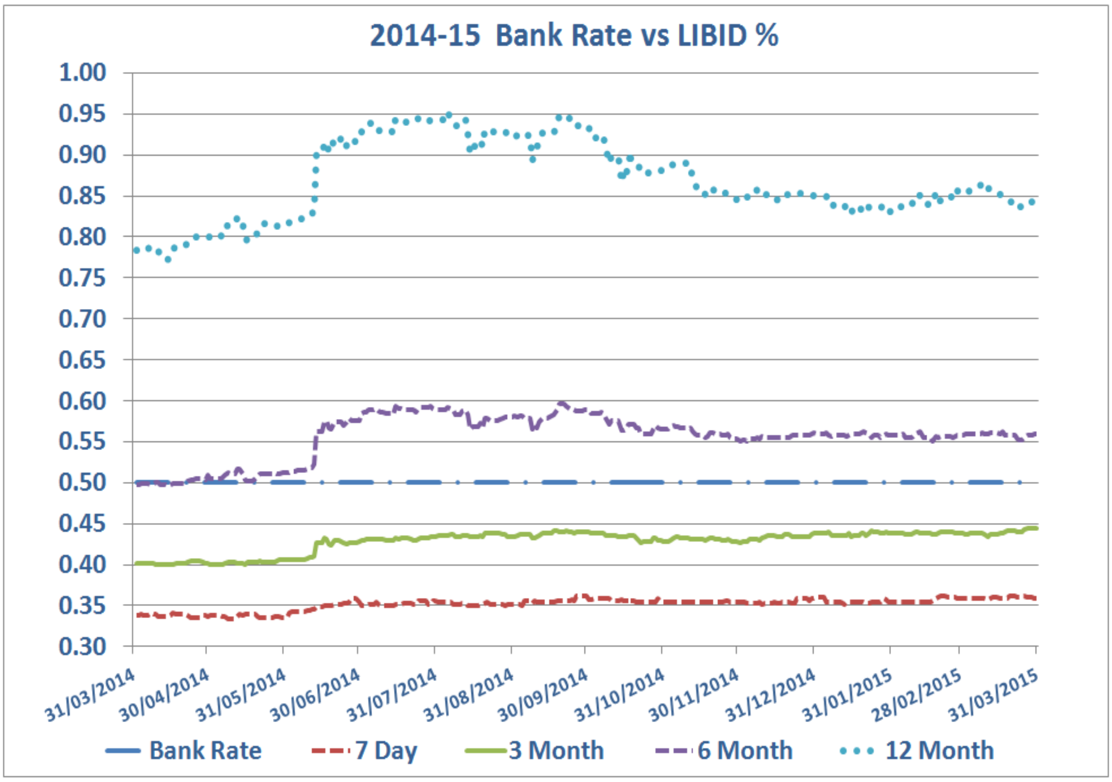
During the year £7.8m of PWLB debt and £550k of market loans matured.

Rescheduling

No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

8. Investment Rates in 2014/15

Bank Rate remained at its historic low of 0.5% throughout the year; it has now remained unchanged for six years. Market expectations as to the timing of the start of monetary tightening started the year at quarter 1 2015 but then moved back to around quarter 3 2016 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.



9. Investment Outturn for 2014/15

Investment Policy – the Council's investment policy is governed by Scottish Government investment regulations, which have been implemented in the annual investment strategy approved by the Council on 20/3/2014. 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 Council had no liquidity difficulties.

Investments held by the Council - the Council maintained an average balance of £56 million of internally managed funds. The internally managed funds earned an average rate of return of 0.692%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.352%.

Appendix 1: Prudential and Treasury Indicators

During 2014/15, the Council 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	2013/14 Actual £000	2014/15 Original £000	2014/15 Actual £000
Capital expenditure	32,685	50,185	36,281
Capital Financing Requirement	256,463	275,239	256,079
Gross borrowing	240,785	247,370	247,280
External debt	161,181	169,315	173,378
Investments	44,350	20,000	56,408
Net borrowing	116,831	149,315	116,970

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council 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 (2014/15) plus the estimates of any additional capital financing requirement for the current (2014/15) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs in 2014/15.

The authorised limit – this Council has kept within the authorised external borrowing limit as shown by the table below.

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

	2014/15 £m
Authorised limit	284
Maximum gross borrowing position	256
Operational boundary	276
Average gross borrowing position	242
Financing costs as a proportion of net revenue stream	10.98%

TABLE 1	31 March 2014 Principal		Rate/ Return	Average Life yrs	31 March 2015 Principal		Rate/ Return	Average Life yrs
Fixed rate funding:								
-PWLB	£108.1m				£100.2m			
-Market	£12.5m	£120.6m	6.8%	22	£12.5m	£112.2m	6.7%	21
Variable rate funding:								
-PWLB								
-Market	£39.3m	£39.3m	4.4%	55	£39.3m	£39.3m	4.4%	54
Temporary Loans		£1.3m	0.3%			£21.9m	0.4%	
Total debt		***£161.2m***	***6.1%***	***30***		***£173.4m***	***5.4%***	***29***
CFR		***£176.8m***				***£179.8m***		
Over/ (under) borrowing		***(£15.6m)***				***(£6.4m)***		
Total investments		***£44.4m***	***0.8%***			***£56.4m***	***0.6%***	
Net debt		**£116.8m**				**£117.0m**		

The maturity structure of the debt portfolio was as follows:

	31 March 2014 Actual £000	2014/15 original limits £000	31 March 2015 Actual £000
Under 12 months	9,662	52,013	31,944
12 months and within 24 months	10,605	52,013	18,376
24 months and within 5 years	23,237	52,013	16,449
5 years and within 10 years	17,540	69,351	6,478
10 years and within 20 years	5	138,702	0
20 years and within 30 years	12,877	138,702	12,877
30 years and within 40 years	15,255	138,702	33,754
40 years and within 50 years	29,999	138,702	22,500
50 years +	42,000	138,702	31,000

All investments were for less than one year.

The exposure to fixed and variable rates was as follows:

	31 March 2014 Actual	2014/15 Original Limits	31 March 2015 Actual
Fixed rate (principal or interest) based on net debt	103%	195%	95%
Variable rate (principal or interest) based on net debt	35%	60%	35%