Essential Reference Paper 'B'

East Herts District Council

Annual Treasury Management Review

2015/16

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1. Introduction

This Council 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 Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 18/02/2015)
- a mid-year (minimum) treasury update report (Audit and Governance Committee 25/11/2015)
- an annual review following the end of the year describing the activity compared to the strategy (Audit and Governance Committee 21/09/2016)

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 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 Audit and Governance Committee before they were reported to the full Council. Member training on treasury management issues was undertaken during the year on 25/11/2015 in order to support members' scrutiny role.

2. The Economy and Interest Rates *(supplied by Capita Asset Services)*

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 caused sharp market volatility in equity prices during the year with corresponding impacts on bond prices and bond yields due to safe haven flows. The Bank Rate, therefore, remained unchanged at 0.5% for the seventh successive year. Economic growth (GDP) in 2015/16 was 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 were for yields to fall to historically low levels as forecasts for inflation were repeatedly revised downwards and expectations of increases in central rates were 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 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 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 Council's treasury (excluding finance leases) position was as follows:

TABLE 1	31 March 2015 Principal		31 March 2016 Principal
Total debt	***£7.5m***		***£7.5m***
CFR	***(£41.9m)***		***(£23.1m)***
Over / (under) borrowing	***(£37.4m)***		***(£15.6m)***
Total investments	***£69.5m***		***£54.2m***
Net debt	**(£62m)**		**(£46.7m)**

4. The Strategy for 2015/16

The expectation for interest rates within the treasury management strategy for 2015/16 anticipated a 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 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.

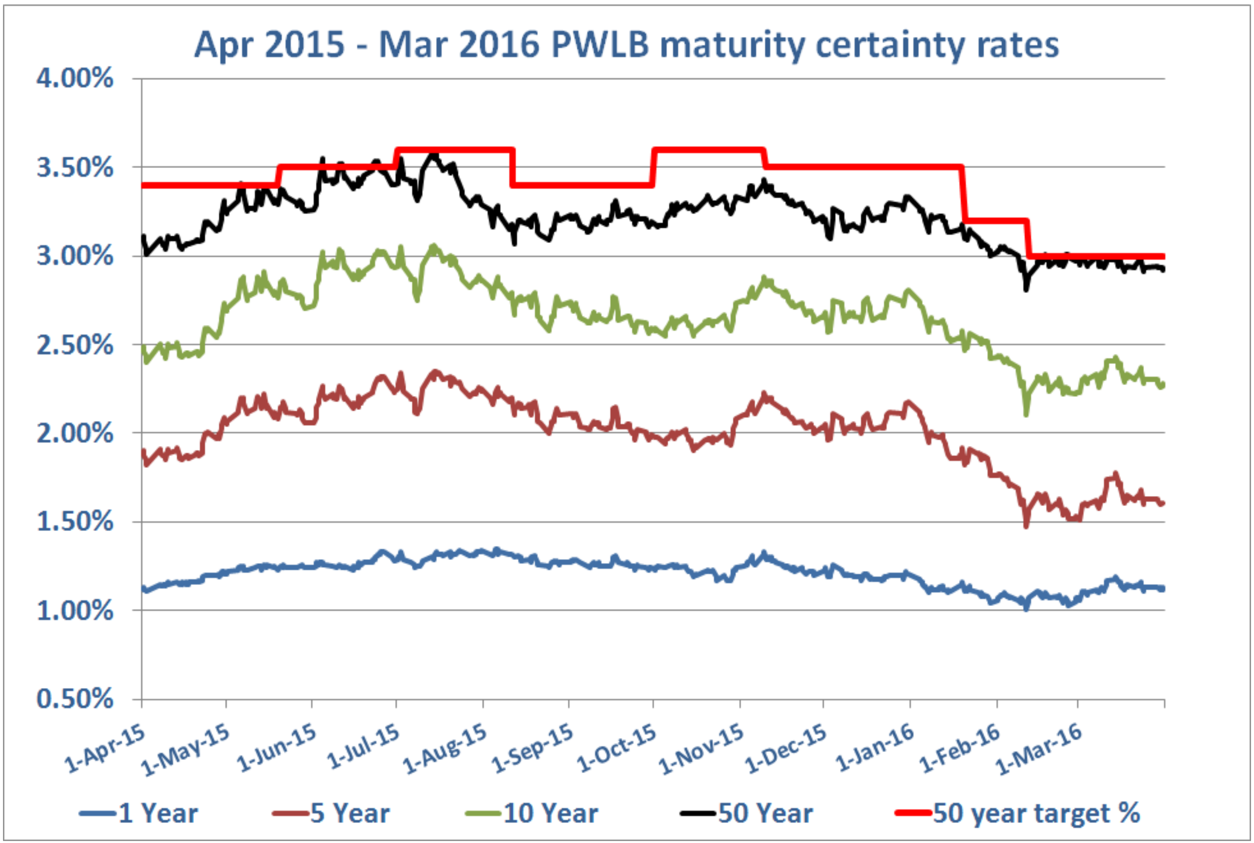
5. The Borrowing Requirement and Debt

The Council'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 General Fund (£m)	(41,895)	(40,799)	(21,080)

6. Borrowing Rates in 2015/16

PWLB certainty maturity 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 – the following loans were outstanding during the year: -

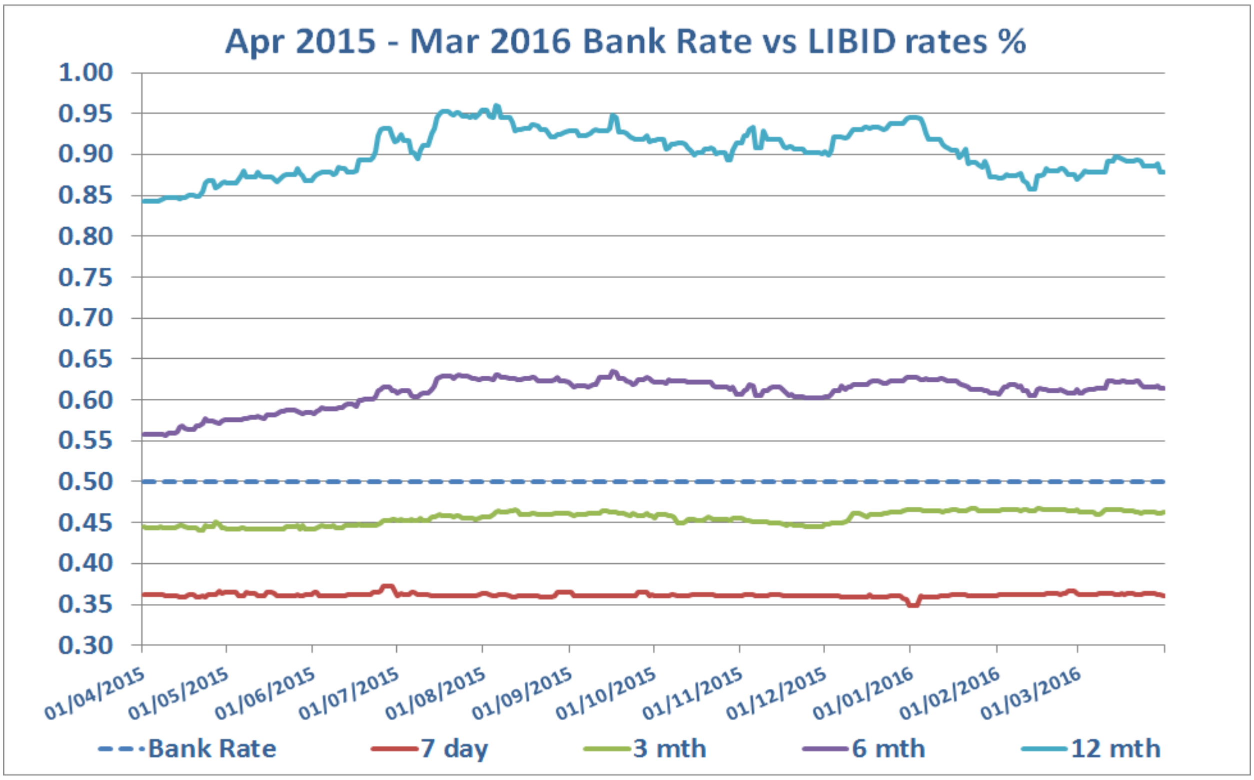
Lender	Principal	Type	Interest Rate	Maturity
PWLB	£1.5m	Fixed interest rate	8.875%	40 years
UBS Secured Bond	£6m	Variable interest rate	8.785%	5 years

No new borrowing was undertaken during the year.

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.

Repayments
No repayments were made by the Council during the year.

8. Investment Rates in 2015/16



The Bank Rate remained at its historic low of 0.5% throughout the year; remaining 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 Council's investment policy is governed by Department for Communities and Local Government (DCLG) guidance, which has been implemented in the annual investment strategy approved by the Council on 18th February 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 (e.g. rating outlooks, credit default swaps, bank share prices).

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 £57.8m of internally managed funds. The internally managed funds earned an average rate of return of 0.85%. The comparable performance indicator is the average 7-day LIBID rate , which was 0.36%.

Investments held with Property Funds – the Council approved the use of property funds up to a value of £20m, at the time of investment. Working with our advisors Capita Asset Services, two funds were chosen, Lothbury Property Trust and Hermes Property Unit Trust. Both funds had waiting lists to invest. The invitation to invest in the Lothbury fund arose in June 2015 and the Hermes fund in December 2015. The performances of these funds are detailed below:

Property Fund	Investments Held	Average Return
Lothbury Property Trust	£10m	3.83%
Hermes Property Unit Trust	£10m	4.35%

Budget
The total interest earned on investments for 2015/16 was £1.089m which exceeded the budget of £867k.

10. Other Issues

During the year the Council made the decision to purchase a site at Old River Lane in Bishop's Stortford. This was an investment of £19.55m to acquire a key town centre site comprising 2 office buildings, 2 car parks and 3 residential properties. The Council was involved in a competitive process to acquire the site where a good level of interest was shown from property companies and institutional investors. An external market valuation by an experienced, qualified RICS Registered Valuer has confirmed the valuation at the price agreed.

Prior to an offer being submitted and the subsequent exchange of contracts a number of Council and Executive meetings were held between members, officers and property experts. These meetings were held to determine whether the council should submit a bid for the site, to ascertain the market value of the site and to approve the value of the bid submitted by the council. Throughout this process expert valuation and legal advice has been provided by independent, external partners.

This investment is part of a wider investment strategy which aims to realise best value from council assets without exposing the council to undue risk. Full Council approved the direct purchase of property as an investment within the Investment Strategy in February 2014 following Executive approval in November 2013.

The investment principles agreed in those meetings have been adhered to with careful consideration of treasury management principles, in summary:

- Security of the council's capital; this is 'institutional' grade property in a prime site and the quality of tenancies has been assessed through credit checks and the spread of lease lengths.
- Yield of at least 4% on property; the expected yield is 5.02% "as-is" with a yield up to 7.20% if fully re-furbished and occupied.
- Liquidity; the council were one of several parties who submitted offers for this site and could re-market the site to realise the cash invested should the council decide to do so.