ANNUAL REPORT ON THE TREASURY MANAGEMENT SERVICE 2015/16

1. The Council's Capital Activity During 2015/16

The Council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or
- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.
- The Council did not borrow during 2015/16

2. Reporting of the Required Prudential and Treasury Indicators

During 2015/16, 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	2014/15 Actual £	2015/16 Actual £
Actual Capital Expenditure	9.503m	7.749m
Total Capital Financing Requirement:	2.000m	2.557m
External Debt	4.900m	7.500m
Investments – Under 1 Year	33.100m	45.107m

The external debt relates to Local Enterprise Partnership for the Health Campus (£ 6.0m) and Watford Business Park (£1.5m) Funding for the Health Campus was received in July 2013 and is due to be repaid in March 2020. The money is being paid over to the LABV (Local Asset Backed Vehicle). Funding for Watford Business Park was received in December 2015 and is also due to be repaid in March 2020.

The actual capital expenditure forms one of the required prudential indicators.

The table below shows the actual capital expenditure and how this was financed.

Actual Capital Expenditure and Financing	2014/15 Actual £	2015/16 Original Budget £	2015/16 Latest Budget £	2015/16 Actual £
Capital Expenditure	9.503	9.918m	16.769m	**7.749m**
Total Capital Expenditure				
Resourced by:				
• Capital Receipts	5.292m	6.824m	10.300m	4.022m
• Capital Grants & Contributions	1.941m	3.056m	5.425m	2.964m
• Reserves	2.270m	0.038m	1.044m	0.763m
Unfinanced Capital Expenditure	**0**	**0**	**0**	**0**

3. Impact of This Activity on the Council's Underlying Indebtedness (the Capital Financing Requirement)

The Council's 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 the 2015/16 unfinanced capital expenditure (see above table), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources. The borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit.

The authorised limit - 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 – 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.

Gross Borrowing Within Authorised Limit	2014/15	2015/16
Authorised Limit	£13m	£20m
Operational Boundary	£10m	£15m
Borrowing Position	£4.9m	£7.5m
Financing Costs as a Proportion of Net Revenue Stream (Interest over net cost of services)	-0.73%	-2.30%

4. Overall Treasury Position and the Impact on Investment Balances

The Council's debt and investment position is organised by the treasury management service in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through Member reporting and through officer activity detailed in the Council's Treasury Management Practices. At the beginning and the end of 2015/16 the Council's treasury position was as follows:

Treasury Position	31 March 2015 Principal £	Rate/ Return %	31 March 2016 Principal £	Rate/ Return %
Total Debt	4.900m		7.500m	
CFR	2.000m		2.557m	
Investments - in House	33.100m	0.68	45.107m	0.75
Total Investments	**40.000m**	**0.68**	**55.164m**	**0.75**

The maturity structure of the investment portfolio was all under one year. The exposure to fixed and variable rates was as follows:

Exposure to Fixed and Variable Rates	31 March 2015 Actual £	31 March 2016 Actual £
Fixed Rate (Principal or Interest)	20.1m	35.1m
Variable Rate (Principal or Interest)	13.0 m	10.0m

5. The Economy and Interest Rates – Capita Asset Services Report

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 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.

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.

On the international scene, concerns have increased about the slowing of the Chinese economy and also its potential vulnerability to both the bursting of a property bubble and major exposure of its banking system to bad debts. The Japanese economy has also suffered disappointing growth in this financial year despite a huge programme of quantitative easing, while two of the major emerging market economies, Russia and Brazil, are in recession. The situations in Ukraine, and in the Middle East with ISIS, have also contributed to volatility.

6. Investment Rates 2015/16 – Capita Asset Services Report

Bank Rate remained at its historic low of 0.5% throughout the year; it has now remained 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.

7. Investment Outturn for 2015/16

Investment Policy – the Council's investment policy is governed by CLG guidance, which was implemented in the annual investment strategy approved by the Council on 27 January 2016. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies. The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

Resources – the Council's longer term cash balances comprise, primarily, revenue and capital resources, although these will be influenced by cash flow considerations.

The Council's core cash resources comprised as follows;-

Balance Sheet Resources	31 March 2015 £	31 March 2016 £
General Fund	1.350m	1.350m
Earmarked Reserves	21.891m	23.783m
Usable Capital Receipts	12.376m	17.486m
Capital Grants Unapplied	0.000m	2.594m
Total	**35.617m**	**45.213m**

Investments Held by the Council - the Council maintained an average balance of £41.550m in 2015/16 of internally managed funds with an average rate of return of 0.70%.