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| **Meeting:** | **Executive / Audit Committee / Council** | **Agenda Item:** | **12** |
| Portfolio Area: | Resources | | |
| **Date:** | **10 November / 11 November / 9 December 2015** | | |

# 2015/16 MID YEAR TREASURY MANAGEMENT REVIEW REPORT

**NON-KEY DECISION**

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## 1. PURPOSE

1.1 To approve updates to the 2015/16 Treasury Management and Investment Strategy.

## 2. RECOMMENDATIONS

2.1 That subject to any comments from Executive and the Audit Committee recommend Council the approve the 2015/16 Treasury Management Mid Year Review and the prudential and treasury indicators in this report.

2.2 That the review of the treasury limits (paragraph 4.7.10 and Appendix C) is noted and the latest approved Countries for investments (paragraph 4.7.12 Appendix D) is recommended for approval by Executive/Council.

## 3. BACKGROUND

3.1 The Council is required under the Local Government Act 2003 to produce a Mid Year Treasury Management Report reviewing treasury management activities including the 2015/16 prudential and treasury indicators. This report meets the requirements of both the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management ((revised 2013) (the Code)) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

3.2. This report covers one of three reporting requirements under the code of practice, the other reports being;

- Annual Treasury Strategy in advance of the year (last reported to Council 25 February 2015)
- Annual Treasury Management Review after the year end (2014/15 was reported to Council 7 October 2015)

3.3 This report summarises:

- Capital expenditure for 2015/16;
- Impact of the expenditure on the Council's underlying indebtedness, (the Capital Financing Requirement);
- Reporting of the required prudential and treasury indicators;
- Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances;
- Summary of interest rates currently available;
- Detailed debt activity; and
- Detailed investment activity.

## 4 REASONS FOR RECOMMENDED COURSE OF ACTION AND OTHER OPTIONS

### 4.1 The Council's Capital Expenditure and Financing 2015/16

4.1.1 Council expenditure can be classified as capital when it is used to purchase assets with a life of more than one year and meets the guidelines laid out in CIPFA accounting practises.

4.1.2 These costs can be financed either by capital resources the Council has on its Balance Sheet for example capital receipts, capital grants or by making a revenue contribution to capital. If sufficient capital resources are not available to fund the expenditure incurred it would give rise to a need to borrow.

4.1.3 The Treasury Strategy and Prudential Indicators for 2015/16 were originally approved by Council in February 2015 and were based on the Draft Capital Strategy approved by Executive in January 2015. Since then additional budget changes have been approved and the Prudential Indicators (2015/16) were updated in the 2014/15 Annual Treasury Management Review, (approved by Council 7 October 2015). The Treasury Management Mid-Year Review Prudential Indicators have been updated with the capital programme reported to this Executive (10 November 2015).

4.1.4 The estimated 2nd quarter monitoring capital expenditure for the year has been used to calculate the prudential indicators included in this report. Table One (shown below) shows the original capital programme, the revised capital programme (approved Executive 10 November 2015) and the financing.

| Table One: 2015/16 Capital Expenditure and Financing | | | |
|---|---|---|---|
| | 2015/16 Original Estimate * £'000 | 2015/16 Revised Annual Treasury Management Review of 2014/15 (Approved Council October 2015) £'000 | 2015/16 Revised Mid-Year Review (Executive November 2015) £'000 |
| **Capital Expenditure:** | | | |
| General Fund Capital Expenditure | 6,725 | 7,786 | 7,267 |
| HRA Capital Expenditure | 28,164 | 28,183 | 28,332 |
| **Total Capital Expenditure** | **34,889** | **35,969** | **35,599** |
| **Resources Available for Capital Expenditure:** | | | |
| • Capital Receipts | (11,233) | (12,137) | (11,682) |
| • Capital Grants /Contributions | (1,159) | (1,738) | (1,849) |
| • Capital Reserves | (1,417) | (1,772) | (1,742) |
| • Revenue contributions | (21,080) | (20,322) | (20,326) |
| **Total Resources Available** | **(34,889)** | **(35,969)** | **(35,599)** |
| **Capital Expenditure Requiring Borrowing 2015/16** | **0** | **0** | **0** |

**Note the 2015/16 Original capital programme is £1,954k less than the revised capital programme due to scheme slippage and other changes.*

### 4.2 The Council's overall need to borrow

4.2.1 Based on the Capital Strategy and Treasury Management Strategy, the treasury service manages the Council's cash position to ensure sufficient cash is available to meet the capital payments. This may be through borrowing from external bodies (such as the Government, through the Public Works Loan Board (PWLB) or the money markets), or utilising cash balances held by the Council in the short to medium term. The Council has not undertaken any new physical borrowing during 2015/16.

4.2.2 In 2015/16 the average cash holding between April and September was £60.3Million (£40.6Million April to September 2014/15). While investment returns are low the "internal" borrowing rate is significantly cheaper than the cost of external borrowing and is a prudent use of the Council's cash balances, unless the conditions in para 4.3.1 (1) apply.

4.2.3 As at the 30 September 2015 the Council had total external borrowing of £212,888,684, (reducing to £209,757,106 by 31 March 2016). The General Fund had £3,473,684 external borrowing, £1,500,000 with a local authority, the remainder with the PWLB. The HRA had all of its external borrowing (£209,415,000) with the PWLB. The majority of the HRA debt (£194,911,000) was taken out in March 2012 to finance the payment required to central government for self-financing. This debt was arranged over a number of loans at fixed rates and with varying maturities. At 31 March 2016, it is also estimated that the HRA will have £1,727,504 internal borrowing.

4.2.4 The HRA borrowing includes £14,504,000 used to fund the pre 2012 decent homes programme. This debt was called 'supported borrowing' under the former HRA subsidy system but now forms part of the HRA debt portfolio.

4.2.5 HRA borrowing is constrained by legislation (unlike the General Fund) and is capped at £217,685,000. As at the 31 March 2016 the "head room" available for new HRA borrowing is £9,542,496.

## 4.3 Cash balances and cash flow management

4.3.1 Current projections are that cash balances will be £37.9Million as at 31 March 2016, which means the Council will not need to take any of its unfinanced borrowing in 2015/16 until such time as either:

(i) interest rates look as if they will rise and the cost of any future need to borrow for any historic spend is forecast to be more expensive over the whole term of the loan.
or (ii) cash balances fall below £10Million.

4.3.2 The Council's cash balances are higher in 2015/16 compared to other years (as shown in Chart One paragraph 4.3.5). However, this financial year repayment of principle on 2 PWLB loans (£5.5Million self-financing) will be made.

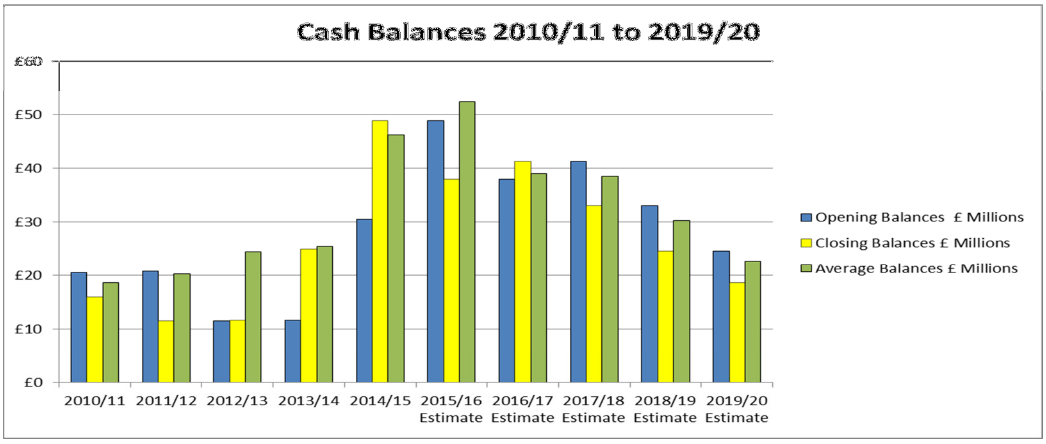
4.3.3 The level of cash balances held by the Council is not indicative to its overall financial health as these balances arise due to the timing difference between when income is received (for example council tax and business rates) and when payments are made (for example debt repayments and NDR refunds).

4.3.4 The level of cash balances is also high due to "One for One" Right to Buy receipts, which have been retained by the Council but have yet to be spent on building or acquiring new council housing (see 4.3.7 below).

4.3.5 The following chart shows the opening, closing and average cash balances held by the Council over the last five years demonstrating that average cash balances held during the year have increased over the last three years and significantly in 2014/15 and 2015/16. However the chart does also show that projections for the next four years follow a downward trend.

4.3.6 The current forecast, shown in chart one, shows the impact on the HRA balances of the 1% rent reduction (resulting in a rent loss of £12Million over four years). However this is before any remedial action is recommended in the revised HRA Business Plan, which may adjust the level of spend over the next 30 years.

**Chart One: Cash Balances**




4.3.7 The projected investment balances for future years include forecast repayment of "One for One" Right to Buy receipts. The Council estimates that it will be required to start repaying this money from 2017/18 as it may be unable to spend it within the time limits set by Government. Interest is payable on the amounts repaid at 4% above Bank of England Base Rate, the interest payments have also been included in the projected balances above. The revised HRA Business Plan updates will provide an update on the use of "One for One" receipts and the need to make any repayments.

**4.4 Borrowing and the 2015/16 Capital Financing Requirement (CFR)**

4.4.1 The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). It represents the amount of debt the Council needs to/has taken to fund the capital programme after repayments and Minimum Revenue Provision (MRP) are taken into account.

4.4.2 The Council's original estimate and latest CFR for the year is shown below, and is one of the key prudential indicators. The estimate of the CFR for 2015/16 has not changed as both the General Fund and HRA programmes are fully funded.

| **Table Two : Capital Financing Requirement 2015/16** | | | |
|---|---|---|---|
| **CFR Calculation** | **2015/16** **Original Estimate** **£'000** | **2015/16** **Revised Annual Treasury Management Review of 2014/15 (October 2015)** **£'000** | **2015/16** **Revised Mid Year Review (November 2015)** **£'000** |
| Closing Capital Financing Requirement (General Fund) | 15,786 | 15,786 | 15,786 |
| Closing Capital Financing Requirement (Housing Revenue Account) | 208,143 | 208,143 | 208,143 |
| **Total CFR** | **223,929** | **223,929** | **223,929** |

4.4.3 Total debt repayments made in the first half of 2015/16 relating principle on PWLB loans was £3,631,579 (to 8 October). A repayment of £131,579 is to be made in February 2016 in relation to General Fund debt and £2Million is to be made in respect of HRA debt in March 2016.

4.4.4 The Council could reduce its CFR by:

- the application of additional capital financing resources (such as unapplied capital receipts) if available; or
- charging more than the statutory revenue charge the Minimum Revenue Provision(MRP) each year through a Voluntary Revenue Provision (VRP) which would increase the cost to the General Fund or HRA.

## 4.5 Minimum Revenue Requirement (MRP)

4.5.1 The Council must base its borrowing decisions in accordance with the Prudential Code which requires the Council to demonstrate a need to borrow and to show the cost of that borrowing for the General Fund is affordable. The Council's MRP policy, as required by CIPFA guidance, is approved annually by Council as part of the Treasury Management Strategy. The calculation of MRP is based upon prior years' borrowing requirement and the life of the assets for which borrowing was required.

4.5.2 MRP will need to be made regardless of whether actual external borrowing has been taken and hence differs from the treasury management arrangements, the latter considers utilising cash balances when borrowing rates are relatively high compared to investment interest earned (as in paragraph 4.2.2).

4.5.3 In 2015/16 the MRP charged to the General Fund is £653,630, based on borrowing. There is currently no borrowing included in the five year capital programme however, there are an estimated capital bids totalling £10Million for the next four years.

## 4.6 Other indicators

4.6.1 The treasury management indicators for 2015/16 onwards have been calculated based on the updated Capital Strategy reported to Executive (10 November 2015). The 2015/16 Capital Strategy was rebased as part of the Integrated Financial Planning process and there will be a further round of capital bidding for the period 2016/17 to 2019/20 as part of the 2016/17 budget setting process and as such the data relating to future years is indicative only and will be subject to change.

4.6.2 The **net borrowing position** of the Council at 31 March 2016 is estimated to be **£171,894,604** of borrowing (total borrowings/loans of £209,757,105 less total investments held of £37,862,501).

4.6.3 The **operational boundary and authorised limit** refer to the borrowing limits within which the treasury team operate. A temporary breach of the operational boundary is permissible for short term cash flow purposes however a breach of the authorised limit would require a report to Council. To date there have been **no breaches** of either limit in 2015/16.

4.6.4 The **ratio of financing costs to net revenue stream** (General Fund interest costs divided by the General Fund net revenue income from Council Tax and RSG/NDR). The revised estimate of the 2015/16 indicator is **6.63%,** 0.4% lower than the estimated in October 7.03%, as interest receivable by the General Fund has increased, lowering the net cost of financing. The forecast increase in investment interest is due to higher average cash balances held during the year, reflecting the profile of capital expenditure and timing of payments for the collection fund.

4.6.5 The full list of Treasury Prudential Indicators is shown in Appendix A updated for the 2014/15 outturn position and latest revised 2015/16 estimates.

## 4.7 Treasury Management Strategy for 2015/16

4.7.1 The Council's debt and investment position is managed by the Treasury Management section to ensure adequate liquidity for revenue and capital activities. In addition investment decisions are based on the security of the investments and spread over a number of counter parties to manage the Council's exposure to risk.

4.7.2 The Council's investment returns are low reflecting the 0.5% Bank of England Base Rate. As at 9th October 2015 the 2015/16 average rate of interest being earnt on investments was 0.6% this compares to 0.5% earned in 2014/15. This exceeded the 7 day LIBOR benchmark rate of 0.49% (source: CAPITA).

4.7.3 The rates earned have also been low as the majority of the investments have been held in short-term variable instruments rather than putting monies out for more than one year which would attract higher investments yields. The majority of investments have been held for less than 12 months anticipating the year end reduction in cash balances and to keep investments liquid (readily available) for day to day service delivery.

4.7.4 Table three illustrates the rates available to the Council over different terms as at 9 October 2015.

| Table Three: Fixed Term Investment Rates Quoted as at 9th October 2015 | | | | | |
|---|---|---|---|---|---|
| **Term** | **HSBC** | **DMO** | **Goldman Sachs** | **Nationwide** | **Lloyds** |
| | % | % | % | % | % |
| 1 Month | 0.23 | 0.25 | not quoted | 0.43 | 0.43 |
| 2 Months | 0.28 | 0.25 | not quoted | 0.46 | not quoted |
| 3 Months | 0.28 | 0.25 | 0.48 | 0.50 | 0.57 |
| 6 Months | 0.38 | 0.25 | 0.67 | 0.66 | 0.75 |
| 9 Months | 0.43 | not quoted | 0.80 | 0.79 | 0.85 |
| 1 Year | 0.48 | not quoted | 0.98 | 0.90 | 1.05 |
| 2 Years | not quoted | not quoted | not quoted | not quoted | not quoted |
| 3 Years | not quoted | not quoted | not quoted | not quoted | not quoted |
| 5 Years | not quoted | not quoted | not quoted | not quoted | not quoted |

4.7.5 While borrowing costs are around 2.8-3.6% it is still prudent to utilise the Council's high cash balances (as shown in paragraph 4.3.5) for short-term internal borrowing. However when borrowing costs start to increase this position may change as future borrowing becomes more expensive. The decision and timing of when to borrow is being monitored by officers.

4.7.6 The Council's treasury position for the first half of year was as follows;

| Table Four Treasury Position | | | | | | |
|---|---|---|---|---|---|---|
| | 2014/15 | | | 2015/16 | | |
| | 31 March 2015 Principal (Actual) £'000s | Rate / Return (Actual) % | Average Life (Yrs) | 31 March 2016 Principal (Forecast) £'000s | Rate / Return (Forecast) % | Average Life (Yrs) |
| Fixed rate loans - PWLB | 214,020 | 3.37 | 18.27 | 208,257 | 3.38 | 17.75 |
| Local Authority Loans | 1,500 | 1.98 | 3.26 | 1,500 | 1.98 | 2.26 |
| **Total Borrowing** | **215,520** | **3.34** | **18.14** | **209,757** | **3.37** | **18** |
| CFR | 230,083 | | | 223,929 | | |
| Over/(under) borrowing* *See table below for movement in year* | (14,563) | | | (14,172) | | |
| **Investments Portfolio** | **48,950** | **0.50** | | **37,863** | | |

** financed by internal borrowing.*

| Decrease in Under-Borrowing as at 31st March 2016 | £'000s | £'000s |
|---|---|---|
| **Under-borrowing as at 31st March 2015** | | **(14,563)** |
| Prudential borrowing identified for 2015/16 Capital Programme | 0 | |
| Actual borrowing taken out in year | 0 | |
| Actual borrowing repaid in the year | (5,763) | |
| MRP reduces CFR, consequently reduces the under-borrowing by | 654 | |
| Principle repaid on HRA Borrowing in Year which Reduces CFR | 5,500 | |
| **Forecast movement in year** | | 391 |
| **Under-Borrowing as at 31st March 2016** | | **(14,172)** |

4.7.7 The maturity structure of the debt portfolio was as follows (see also Appendix B):

| Table Five Maturity of Debt Portfolio for 2014/15 and 2015/16 | | |
|---|---|---|
| **Time to maturity** | **31 March 2015 Actual £'000s** | **30th September 2015 Actual £'000s** |
| Maturing within one year | 5,763 | 3,132 |
| 1 year or more and less than 2 years | 263 | 263 |
| 2 years or more and less than 5 years | 6,031 | 6,030 |
| 5 years or more and less than 10 years | 789 | 789 |
| 10 years or more | 202,674 | 202,674 |
| **Total** | **215,520** | **212,888** |

4.7.8 The Council has two investments which are for longer than one year, both of these are with local authorities; their total value is £4Million. All other investments held during the first half of 2015/16 are due to mature within one year. A summary of the Council's exposure to fixed and variable rate investments is shown below in Table Six. (See also Appendix B).

| Table Six : Fixed and Variable Rate Investment Totals | | |
|---|---|---|
| | **31 March 2015 Actual £'000s** | **9th October 2015 Actual £'000s** |
| Fixed rate principal | 15,800 | 35,540 |
| Variable rate principal | 33,150 | 22,586 |
| Total | 48,950 | 58,126 |

4.7.9 The Debt Management Office (DMO) is used as a 'safe haven' and permission for unlimited deposits. When cash balances are high the DMO is used so that counter party limits are not breached. There have been no investments deposited with the DMO during 2015/16, as the two tier treasury management limits approved by Council 8 October 2014 (see also Appendix C table 3), has relieved the counter party pressures.

4.7.10 As part of the mid-year review it is not proposed to make any changes to the current treasury management limits, which are detailed in Appendix C

4.7.11 Cashflow forecasts do not indicate that cash balances should fall below £30Million in 2015/16, there is a very small risk that these limits may be breached temporarily should cash balances fall unexpectedly below £30Million, should it occur this would be notified to the Chief Finance Officer.

4.7.12 The latest list of "Approved Countries for Investments" is detailed in Appendix D. This lists the countries that the Council may invest with, provided they continue to meet the minimum rating of AA-. One country has been removed from the list, Saudia Arabia, as the council has not ever invested with counterparties from this country.

4.7.13 Officers have also reviewed the Operational Boundary and Authorised Limit for the General Fund, these limits do not require any changes at present.

## 4.8 Economic Review & Interest Rate Outlook

4.8.1 **UK Growth** - UK GDP growth was 0.8%, 0.6% and 0.6% in quarters 2, 3 and 4 respectively in 2014. UK GDP growth rate was weak at 0.4% in the first quarter of 2015 and stronger in the second quarter at 0.7% but is expected to weaken slightly at 0.5% in quarter 3. The Bank of England is forecasting growth to remain around 2.4 – 2.8% over the next three years.

4.8.2 **Wage inflation** – The unemployment rate for those aged 16 and above was 2.6% for quarter 2 of 2015. Wage inflation at 2.9% is now running above the rate of CPI inflation.

4.8.3 **UK Credit Rating** - There has been no change to the UK's credit ratings of AAA by Standard and Poor (June 2014) and AA+ by Moody (February 2013) or Fitch (April 2013).

4.8.4 **Barclays Bank** is no longer an approved investment counter party of the Council as its credit rating has been lowered by Standard and Poor in June 2015. The Council had an investment of £4Million which was placed with Barclays in April 2015, this matured on 15th October and no new investments have been made with the bank.

4.8.4 **UK Debt** - The March 2015 Budget forecasted borrowing to decrease to £90.2 Billion by the end of 2014/15, and to further decrease to £75.3 Billion in 2015/16 and an overall surplus of £5.2bn is anticipated in 2018/19. The July 2015 Summer Budget confirmed that the national debt is falling in 2015/16 but that the UK is still running a 4.69% deficit and debt is above 80% of GDP.

4.8.5 **Inflation -** Consumer Price Index (CPI) for 2015/16 are shown in the table below. The Monetary Policy Committee (MPC) forecast that inflation will barely get back up to the 2% target within the two to three year time horizon.

| | **April 2015** | **May 2015** | **June 2015** | **July 2015** | **August 2015** |
|---|---|---|---|---|---|
| CPI Rate | -0.10% | 0.10% | 0% | 0.10% | 0% |

4.8.6 **Interest Rate** - The latest forecast by the Council's Treasury advisor Capita Asset Services is an increase in the Base Bank Rate in Quarter 2 of 2016. It is expected that increases after Q2 will be at much slower pace and much lower levels than those experienced before 2008.

4.8.7 Capita Asset Services has provided the following interest rate forecast (as at September 2015):

| | Dec-15 | Mar-16 | Jun-16 | Sep-16 | Dec-16 | Mar-17 | Jun-17 | Sep-17 | Dec-17 | Mar-18 | Jun-18 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Bank rate | 0.50% | 0.50% | 0.75% | 0.75% | 1.00% | 1.00% | 1.25% | 1.50% | 1.50% | 1.75% | 1.75% |
| 5yr PWLB rate | 2.40% | 2.50% | 2.60% | 2.80% | 2.90% | 3.00% | 3.10% | 3.20% | 3.30% | 3.40% | 3.50% |
| 10yr PWLB rate | 3.00% | 3.20% | 3.30% | 3.40% | 3.50% | 3.70% | 3.80% | 3.90% | 4.00% | 4.10% | 4.20% |
| 25yr PWLB rate | 3.60% | 3.80% | 3.90% | 4.00% | 4.10% | 4.20% | 4.30% | 4.40% | 4.50% | 4.60% | 4.60% |
| 50yr PWLB rate | 3.60% | 3.80% | 3.90% | 4.00% | 4.10% | 4.20% | 4.30% | 4.40% | 4.50% | 4.60% | 4.60% |

# 5. IMPLICATIONS

## 5.1 Financial Implications

5.1.1 This report is of a financial nature and reviews the treasury management function for the 2015/16. Any consequential financial impacts of the Strategy have been reflected in the November Capital Strategy update and the 2nd Quarter 2015/16 budget monitoring report.

**5.2 Legal Implications**

5.2.1 Approval of the Prudential Code Indicators and the Treasury Management Strategy Indicators are intended to ensure that the Council complies with relevant legislation and best practice.

**5.3 Risk Implications**

5.3.1 The table below identifies the risks if the recommendations are agreed. The risks have been assessed in accordance with the Council's risk management strategy.

| Description of risk | | Mitigation | Residual Risk Level |
|---|---|---|---|
| 1. | Investment balances increase/decrease and monies placed with banking groups exceed approved Counter Party Limits | The Treasury Team would actively seek to find alternative Counter Parties to lend to, or seek Council approval to increase the Counter Party Limits | L |
| 2. | There is an increase in the capital programme which cannot be resourced from available resources and can exceed the Council's borrowing limit. | Operational and authorised boundary should have sufficient headroom above CFR to meet the Council's borrowing requirement arising from the Capital Strategy. | L |
| 3 | The Council is unable to defer spend within the General Fund capital programme in future years or identify resources to fund the unsupported borrowing in the Capital Strategy. | This would increase the cost of borrowing to the General Fund and would require funding. Integrated Financial Planning Process prioritises capital projects. | L |
| 4 | The Council invests funds with a bank which is unable to meet the repayment. | The Counter Party ratings are reviewed on a weekly basis and should prevent placing funds with banks at risk. The Council has a very strict lending criteria. | L |

**5.4 Equalities and Diversity Implications**

5.4.1 All the services identified in the report have their own Equalities Impact Assessments, which are reviewed where appropriate.

## 6 BACKGROUND DOCUMENTS

BD1 Prudential Code Indicators and Treasury Management Strategy 2015/16 (25 February 2015 Council)

BD2 Annual Treasury Management Review of 2015/16

## 7 APPENDICES

- Appendix A – Prudential Indicators for Mid Year Review.
- Appendix B – Debt Portfolio
- Appendix C – Specified & Non-Specified Investment Criteria
- Appendix D – Approved Countries for Investments