Item No: 6.6	Classification: Open	Date: 12 July 2017	Meeting Name: Council Assembly
Report title:		Treasury Management Performance – 2016-17 Annual Report and Prudential Indicators for Capital Finance and Treasury Management	
Wards or Groups affected:		All	
From:		Strategic Director of Finance and Governance	

RECOMMENDATION

1. That Council Assembly notes the 2016-17 outturn for the council's treasury management and that:

   - all treasury management activity was undertaken in compliance with the approved treasury management strategy and with the council's prudential indicators.
   - the balance remaining on all external loans at 31 March 2017 was £458m (£371m HRA and £87m general fund). Loans totaling £5m were repaid during the year. No new borrowing or debt rescheduling was undertaken during the period.
   - in the year to March 2017 the average investment balance was £188m and the balance of investments at 31 March 2017 stood at £159m. The return on investments was 0.71%.

BACKGROUND INFORMATION

2. In compliance with the Local Government Act 2003, the council has adopted the Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management Code of Practice (the Code). The Code requires local authorities to determine an annual treasury management strategy and, as a minimum, formally report on their treasury activities and arrangements to Council Assembly mid-year and after the year-end.

3. The Code provides the following objective with regard to treasury management:

   "It is important that treasury management policies adequately reflect risk and in particular security, liquidity and yield risk, in that order of importance. No treasury management transaction is without risk and management of risks is the key purpose of the treasury management strategy."

4. The 2016-17 treasury management strategy was approved by Council Assembly in February 2016. Under financial delegation, all executive, managerial and operational decisions are the responsibility of the strategic director of finance and governance.

5. The council is exposed to financial risks from short term investments, existing external debt, as well as future borrowing requirements arising from the council's capital programme. The risks include potential losses from investments and increased borrowing costs from changing interest rates.

6. The key issues covered in this report are:

- The council's borrowing strategy and debt management position
- Investment performance and activity
- Prudential indicators for 2016-17.

KEY ISSUES FOR CONSIDERATION

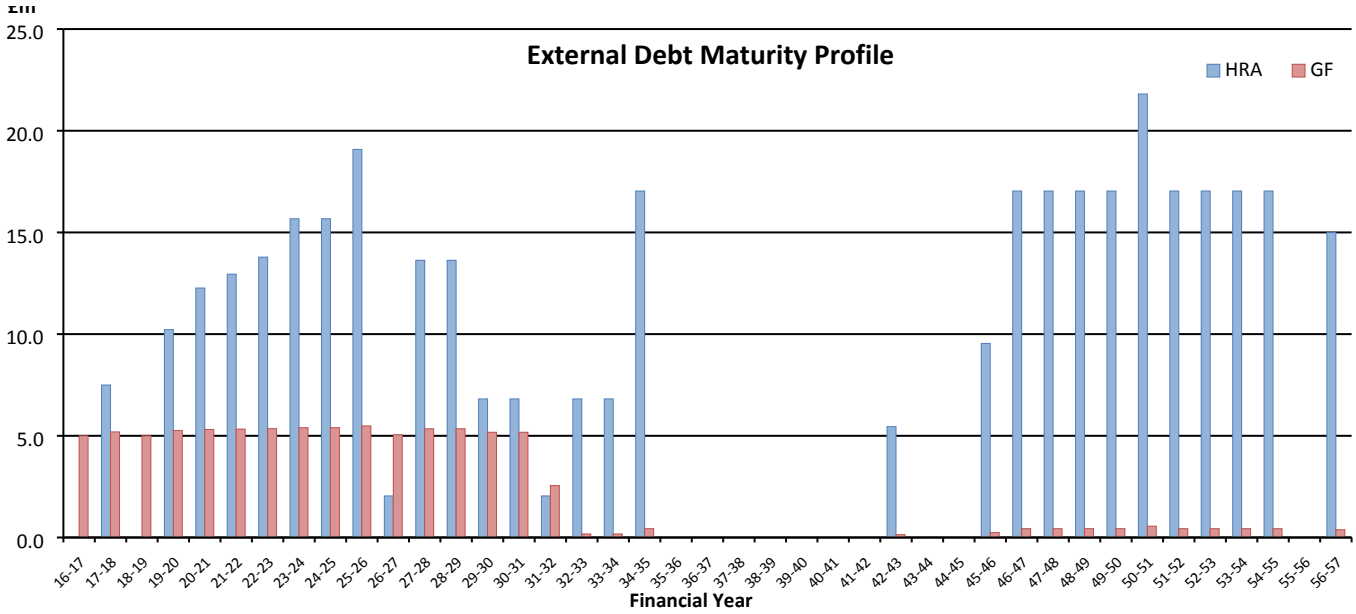
Borrowing strategy and debt management activity and position

7. The council's outstanding debt portfolio, used to fund historical capital expenditure for HRA and general fund, stood at £458m as at 31 March 2017 with £371m attributable to the HRA and £87m to the general fund.

8. All outstanding debt was borrowed from the Public Works Loans Board (PWLB), part of HM Treasury, at fixed rates of interest. During 2016-17, £5m of debt principal matured and was repaid to PWLB.

9. The weighted average rate of interest for the council's debt portfolio is 5.5% as at 31 March 2017. This reflects the largely historical nature of the debt, the majority of which was drawn prior to 2008. The PWLB charges a premium to repay existing debt in advance of maturity, the scale of this premium means that early repayment of debt is not currently beneficial to the council.

10. The maturity profile of outstanding borrowings as at 31 March 2017 is shown in the below chart.



11. The council has an increasing requirement for capital expenditure, as set out in the Capital Programme Refresh 2016-17 to 2025-26. Capital expenditure that is not funded by capital receipts, grants or developer contributions will need to be

funded by borrowing.

12. The debt management strategy for the council as part of the treasury management strategy 2017-18 is to pursue a policy of internal borrowing, which is the use of existing reserves and balances to fund capital expenditure rather than the use of external borrowing.

13. The use of internal borrowing allows the council to minimise unnecessary external borrowing costs by only borrowing when needed for liquidity, or to benefit from advantageous borrowing rates. Borrowing in advance of need creates a 'cost of carry' which is the difference between the short term investment income earned through holding cash balances compared against longer term external debt financing costs.

14. Efficient use of existing council resources to fund capital expenditure through internal borrowing also significantly reduces the council's counterparty risk inherent in the investment of cash balances.

15. Short term interest rates have remained, and are likely to remain, significantly lower than the cost of external borrowing, therefore it is more cost effective to utilise existing council resources to fund capital expenditure.

16. The level of internal borrowing for the council as at 31 March 2017 is £224m. At some point, the council will need to borrow externally as resources used for internal borrowing, but budgeted for other purposes, are spent. The extent of external borrowing required will depend upon the level of existing balances and cashflow forecasts for the council. The council's investment balances as at the 31 March 2017 were £159m leaving headroom for a continuation of the internal borrowing strategy.

17. Officers regularly monitor current and forecast interest rates to determine the appropriateness of the internal borrowing strategy, so that the reduction in current borrowing costs from use of internal balances, is not offset by higher borrowing costs in the future.

Borrowing Sources

18. All historical debt for the council has been drawn from the PWLB, however future borrowing could come from a variety of different sources. The council could borrow through other financial institutions and banks, the Municipal Bond Agency, or directly from other local authorities. Borrowing from other local authorities can often be much cheaper than other sources for short term agreements.

Provisions for repayment of debt

19. Each year, the general fund sets aside sums, known as the minimum revenue provision (MRP), to reduce its borrowing liabilities. In February 2016 council assembly approved an updated MRP strategy. The revised approach continues to make a prudent provision for the repayment of debt but now takes account of other factors, most notably affordability. In 2016-17 £7m (£7m during 2015-16) was set aside to reduce the capital financing requirement.

20. The HRA can also set aside sums to reduce borrowing liabilities. During 2016-17 no additional balances were set aside for repayment of debt, maintaining the headroom for future capital finance at £184m. The overall level of internal borrowing at 31 March 2017, after accounting for additional provisions, increased by £26m to £224m (£207m general fund, £17m HRA). The increase in internal borrowing reflects general fund capital spend that is not funded by existing resources, such as capital receipts or grants, after adjusting for debt repayment provisions. The council's capital spending programme is set out in more detail in the capital monitoring outturn report due to Cabinet on 18 July 2017.

21. The PWLB continues to operate a spread of approximately 1% between "premature repayment rates" and "new loan" rates so the premium charge for early repayment of PWLB debt remained expensive for the council's portfolio and therefore unattractive for debt rescheduling activity.

Investment strategy and investment activity and position

22. The council has significant invested funds, representing income received in advance of expenditure plus balances and reserves held. Council cash that is not immediately required for current expenditure is invested in money market instruments in accordance with the DCLG Guidance on Local Authority Investments and the approved investment strategy. The guidance gives priority to security and liquidity and the council's aim is to achieve a yield commensurate with these principles.

23. In the year to 31 March 2017 the average daily investment balance was £188m (£238m for 2015-16) and the value at 31 March 2017 stood at £159m (£144m 2016).

24. Council investments are managed both in-house and delegated to two fund managers: Alliance Bernstein and Aberdeen Asset Management. The focus for in-house investment is to meet variable near term cash liquidity requirements, principally using money market funds and, to a lesser extent, call accounts and term deposits diversified across major banks and building societies.

25. The external fund managers invest over a longer term in UK government gilts, supranational bank bonds, and certificates of deposits issued by major banks/ building societies. The use of fund managers has the advantage of diversification of investment risk, coupled with the services of professional fund managers, which over the longer-term, provides enhanced returns within the council's risk appetite. Although investments can be redeemed from the fund managers at short notice, the intention is to hold them for the medium term. Their performance and suitability in meeting the council's investment objectives are regularly monitored.

26. The average return on investments in 2016-17 was 0.71% (0.77% 2015-16), reflecting the prudent strategy in place. The weighted average duration of investments as at the 31 March 2017 was six months, for comparative purposes the six month LIBID averaged 0.6% throughout 2016-17.

27. The distribution of investments by maturity and credit rating as at 31 March 2017 is set out in the table below:

Maturity Profile and Credit Rating	A	AA	AAA	Grand Total
Less than 1 year	18%	11%	51%	80%
1-2		2%	11%	13%
2-5			7%	7%
Grand Total	**18%**	**13%**	**69%**	**100%**

AAA represents the highest credit quality, AA represents very high credit quality and A high credit quality.

Prudential Indicators - Actuals

28. Local authority borrowing, investment and capital finance activity is supported by the Prudential Code for Capital Finance, the Treasury Management in the Public Services Code of Practice and related guidance published by CIPFA. The codes require councils to set a series of indicators and limits each year. The 2016-17 indicators were agreed in February 2016, before the start of the year and enabled the strategic director of finance and governance to carry out his responsibilities in this area. The 2016-17 Prudential Indicator outturn details are included at Appendix A.

29. The council has complied with its Prudential Indicators throughout 2016-17.

SUPPLEMENTAL ADVICE FROM OTHER OFFICERS

Director of Law and Democracy

30. The constitution determines that agreeing the treasury management strategy is a function of the council assembly and that review and scrutiny of strategies and policies is the responsibility of the audit, governance and standards committee.

31. Financial standing orders require the strategic director of finance and governance to set out the treasury management strategy for consideration and decision by council assembly, and report on activity on a regular basis to cabinet and at mid and year-end to council assembly. Furthermore all executive and operational decisions are delegated to the strategic director of finance and governance.

32. The Local Government Act 2003 ("the 2003 Act") and supporting regulations require local authorities to determine annual borrowing limits and have regard to the Prudential Code for Capital Finance, and the Treasury Management in the Public Services Code of Practice and Guidance, published by the Chartered Institute of Public Finance and Accountancy, when considering borrowing and investment strategies, determining or changing borrowing limits or prudential indicators.

33. Section 15(1) of the 2003 Act requires a local authority "to have regard (a) to such guidance as the Secretary of State may issue". This guidance is found in the Department of Communities and Local Government Guidance on Local Authority Investments updated March 2010 and there is statutory guidance on the Minimum Revenue Provision (MRP) made under section 21(1A) of the 2003 Act.

34. Section 12 of the 2003 Act grants local authorities the powers to invest for any

purpose relevant to its functions or for the purposes of the prudent management of its financial affairs.

BACKGROUND DOCUMENTS

Background Papers	Held at	Contact
None		

APPENDICES

No.	Title
Appendix A	Prudential Indicators – 2016-17 Actuals

AUDIT TRAIL

Lead Officer	Duncan Whitfield, Strategic Director of Finance and Governance	
Report Author	Jennifer Seeley, Director of Finance	
Version	22 June 2017	
Version Date	Final	
Key Decision	No	
CONSULTATION WITH OTHER OFFICERS / DIRECTORATES / CABINET MEMBER		
Officer Title	**Comments sought**	**Comments included**
Director of Law and Democracy	Yes	Yes
Strategic Director of Finance and Governance	Not applicable	Not applicable
Cabinet Member	Yes	Yes
Final Report Sent to Constitutional Team		26 June 2017

APPENDIX A

PRUDENTIAL INDICATORS: 2016-17 ACTUALS

BACKGROUND

1. Capital finance, borrowing and investment arrangements are supported by a series of prudential indicators, drawn from the Prudential Code on Capital Finance for Local Authorities and the Treasury Management in the Public Services Code of Practice plus Guidance, published by CIPFA. The Local Government Act 2003 requires that councils have regard to these codes and this appendix sets out the 2016-17 outturn indicators drawn from the council's draft accounts for that year.

2. The indicators are grouped into three broad areas: affordability and prudence, capital finance and treasury management. The indicators are of a technical nature and existing budgets take account of capital finance and treasury activities. The indicators themselves have no effect on those budgets.

INDICATORS ON AFFORDABILITY AND PRUDENCE

3. The indicators below are for affordability and prudence.

2015-16	2016-17	
		Ratio of Financing Cost to Net Revenue Stream A measure of the cost of borrowing and long term liabilities (e.g. PFI) net of interest income and set-asides, as a percentage of revenue.
10%	9%	HRA
6%	4%	General fund
		Incremental Impact of Capital Spend A measure of the effect of capital plans on council tax and rents. All spend in 2015-16, and all HRA spend during 2016-17 was contained within existing resources.
N/A	N/A	Weekly rents
N/A	£8	Annual Council tax – band D
		Capital Financing Requirements (CFR) and Gross Debt The CFR is the balance remaining on past capital expenditure financed through debt and long term liabilities (e.g. PFI). The level of gross debt should not exceed the CFR unless prudent over the short term. Actual gross debt remained below the CFR throughout 2016-17 on account of cash balances, internal borrowing and PFI transactions.
£776m	£806m	CFR
£469m	£463m	Maximum Gross Debt in the Year

INDICATORS ON CAPITAL FINANCE

4. The indicators below are for capital finance.

2015-16	2016-17	
		Capital Expenditure Capital expenditure includes PFI funded spend.
£244m	£153m	HRA
£73m	£99m	General fund
£317m	**£252m**	**Total**
		Capital Financing Requirement (CFR) The CFR is the balance on past capital expenditure financed through borrowing and long term liabilities (e.g. PFI).
£393m	£393m	HRA
£383m	£413m	General fund
£776m	**£806m**	**Total**
		HRA Indebtedness Limit A limit determined by the government below which the HRA CFR must remain. The HRA CFR has remained within the indebtedness limit.
£577m	£577m	HRA indebtedness limit determined by the government
£393m	£393m	Actual HRA CFR

INDICATORS ON TREASURY MANAGEMENT

5. The indicators below are for treasury management.

2015-16	2016-17 Limit	2016-17 Outturn	
			Operational Boundary on Debt and Authorised Limits for External Debt These are limits the council determines to accommodate borrowing and long term liabilities. The lower limit is the operational boundary and takes account of existing positions and ordinary activity and the higher limit is the authorised limit, enabling additional borrowing to be taken for very short periods, in the interest of prudence, within a risk controlled framework. No new loans were drawn and as the council was able to access internal cash in place of borrowing, it remained below the limits throughout 2016-17.
			Operational Boundary
£469m	£783m	£463m	Borrowing (maximum outstanding in year)
£114m	£110m	£105m	Other Long Term Liabilities
£583m	**£893m**	**£568m**	**Total**
			Authorised Limit
£469m	£1,088m	£463m	Borrowing (maximum outstanding in year)
£114m	£126m	£105m	Other Long Term Liabilities
£583m	**£1,214m**	**£568m**	**Total**

2015-16	2016-17 Limit	2016-17 Outturn	
69%	100%	64%	**Gross and Net Debt** An upper limit on net debt as a percentage of gross debt. The net debt has remained below gross on account of investments held to meet spend.
			Fixed and Variable Rate Upper Limits Limits recognising existing positions with flexibility to vary exposure within a risk controlled framework should it be prudent.
£469m	£1,088m	£463m	Fixed rate debt (maximum outstanding in year)
£0m	£272m	£0m	Variable rate debt
			Maturity Structure of Borrowing Limits accommodating existing positions with flexibility to vary exposure within a risk controlled framework.
1%	20%	1%	Under 1 year
1%	20%	3%	1 year and within 2 years
7%	30%	8%	2 years and within 5 years
21%	40%	23%	5 years and within 10 years
28%	50%	23%	10 years and within 20 years
1%	50%	3%	20 years and within 30 years
37%	50%	35%	30 years and within 40 years
3%	50%	3%	40 years and within 50 years
			Limits on Investments Greater than One Year Caps on the maximum exposure to longer investments, while recognising benefits from prudent exposure within a risk controlled framework. Actual exposure has remained cautious in view of market volatility.
19%	50%	20%	Percentage longer than one year
8 months	2 years	7 months	Overall maximum average maturity