Item No: 6.1	Classification: Open	Date: 13 July 2016	Meeting Name: Council Assembly
Report title:		Treasury Management Performance – 2015-16 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 this 2015-16 outturn report on 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 loans at 31 March 2016 was £463m (£371m HRA and £92m General Fund). Loans totalling £6.4m were repaid during the year. No new borrowing or debt rescheduling were undertaken during the period.

   - in the year to March 2016 the sum invested averaged £237m and the balance of investments at 31 March 2016 stood at £144m. The average return on investments was 0.77% (0.73% 2014-15).

   - following the result of the European Union referendum vote no immediate changes to our overall treasury management strategy are proposed.

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 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 CIPFA 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 2015-16 Treasury Management Strategy was approved by council assembly in February 2015. Under financial delegation all executive,

managerial and operational decisions are the responsibility of the strategic director of finance and governance.

5. The council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The key issues covered in this report are:

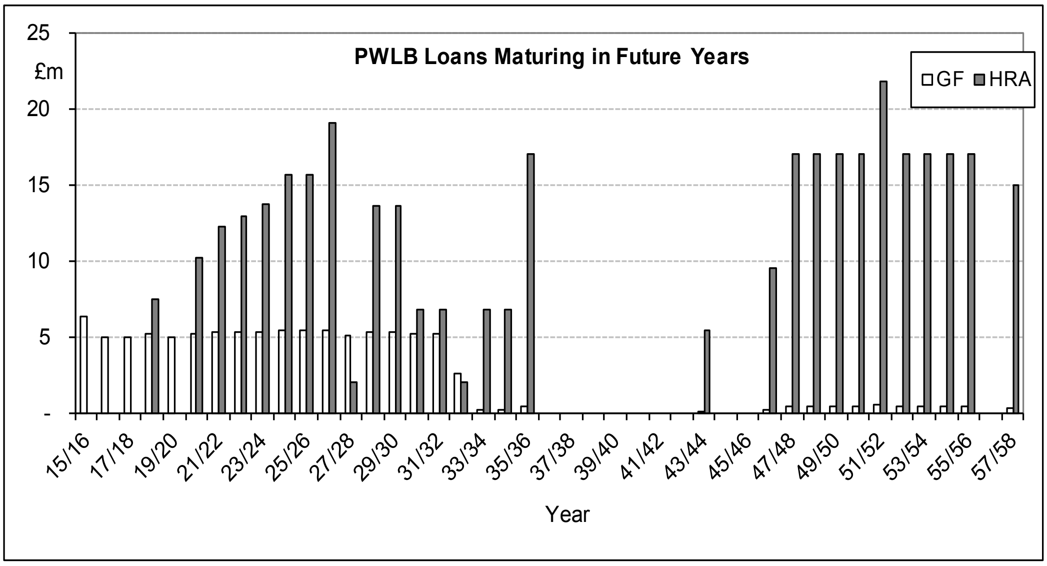
- treasury activity during 2015-16 and treasury position at 31 March 2016
- confirmation of continuing compliance with treasury and prudential indicators
- update on the treasury management strategy following the outcome of the European Union referendum result.

KEY ISSUES FOR CONSIDERATION

Borrowing strategy and debt management activity/position

6. At 31 March 2016 the council held £463m of loans (£371m HRA and £92m General Fund), a decrease of £6.4m on 31 March 2015.

7. The majority of loans were taken out many years ago to pay for investment in housing and general fund capital spend when rates were high. The loans are all from the Public Works Loans Board (PWLB) at fixed rates. In 2015-16, £6.4m loans (all General Fund) fell for repayment and were paid off. The amounts falling due for repayment in the future are set out in the chart below.



8. Affordability and the “cost of carry” remained important influences on the borrowing strategy alongside the consideration that for any borrowing undertaken ahead of need, the proceeds would have to be invested in the money markets at rates of interest significantly lower than the cost of borrowing. As short term interest rates have remained and are likely to remain, at least over the forthcoming two years, lower than long-term rates, it has been more cost effective in the short-term to use internal resources. However should cash supporting internal borrowing be needed in the future for spend, external borrowing would be necessary.

9. 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 2015-16 £6.8m was set aside to reduce the capital financing requirement.

10. The HRA is also setting aside sums to reduce its own borrowing liabilities. In 2015-16 the HRA set-aside was £8m, raising the headroom for future capital finance from £176m to £184m. The sums set-aside also reduced the draw on internal borrowing to support past capital spend. Following the set-asides, the level of internal borrowing in 2015-16 fell by £10m and closed the year at £198m (£181m General Fund, £17m HRA).

11. 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.

12. The LGA Bond Agency was established in 2014 by the Local Government Association as an alternative to the PWLB and has plans to issue bonds on the capital markets and lend the proceeds to local authorities. In early 2016 the Agency declared itself open for business. The council’s own contribution is £200,000. The agency is looking to lend funds at a slightly lower rate than the PWLB. The terms will be fixed when the first bond is issued and potential borrowers will assess any savings in the rate against any joint and several guarantee or other conditions the Agency places. Any borrowing the council needs in the future will be taken from whichever source is the cheapest, having regard to any conditions of borrowing.

Investment strategy and investment activity and position

13. The council has held significant invested funds, representing income received in advance of expenditure plus balances and reserves held. Council cash that is not immediately used in spend 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.

14. Over the course of 2015-16 the sums held in investments averaged £237m (£210m in 2014-15) and, as net cash outflow increased towards the end of 2015-16, closed the year with a balance of £144m (£165m at 31 March 2015).

15. The investments are managed by an in-house operation and two fund managers, AllianceBernstein and Aberdeen Asset Managers. In-house, the focus is on meeting variable day to day cash requirements principally using money market funds and, to a lesser extent, call accounts and term deposits diversified across major banks and building societies.

16. The fund managers invest more stable cash over a longer term within a risk controlled framework in UK government gilts, supranational bank bonds, and certificates of deposits issued by major banks/building societies. The use of fund managers has the advantages 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 money 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.

17. The average return on investments in 2015-16 was 0.77% (0.73% 2014-15), reflecting the prudent strategy in place. Base rates in the UK have been held at 0.50% since 2009. The council's investment income for the year was £1.4m (£1.1m in 2014/15).

18. The distribution of investments across counterparties, maturities and instruments at 31 March 2016 is set out in the tables and charts below.

		CREDIT RATING			FUND			
Couterparty	Country Of Origin	Sovereign Rating	Long-term	Short term	Aberdeen £m	Alliance £m	In house £m	Grand Total £m
ABBEY NATIONAL TREASURY SERVICI	GREAT BRITAIN	AA+	AAA		-	1.4	-	1.4
AUSTRALIA & NEW ZEALAND BANKIN	AUSTRALIA	AAA	AA-	F1+	2.0	1.4	-	3.4
BANK NEDERLANDSE GEMEENTEN N'	NETHERLANDS	AAA	AAA		-	0.4	-	0.4
BANK OF MONTREAL	CANADA	AAA	AA-	F1+	-	1.5	-	1.5
BANK OF NOVA SCOTIA	CANADA	AAA	AA-	F1+	2.0	1.4	-	3.4
BARCLAYS BANK PLC	GREAT BRITAIN	AA+	A	F1	-	0.8	-	0.8
BNP PARIBAS	FRANCE	AA	A1	F1	3.5	3.5	-	7.0
BRITISH POUND	GREAT BRITAIN	AA+	AA+		0.2	0.2	-	0.5
CANADIAN IMPERIAL BANK	CANADA	AAA	AA-	F1+	2.0	1.4	-	3.4
CITIBANK LONDON	UNITED STATES	AAA	A		2.0	-	-	2.0
COMMONWEALTH BANK OF AUSTRA	AUSTRALIA	AAA	AA-	F1+	4.3	1.4	-	5.7
COOPERATIEVE CENTRALE RAIFFEISE	NETHERLANDS	AAA	A		1.0	-	-	1.0
CREDIT AGRICOLE CORP & INVST BAI	FRANCE	AA	A	F1	3.0	2.3	-	5.3
CREDIT SUISSE AG/LONDON	SWITZERLAND	AAA	A	F1	1.2	1.3	-	2.5
DANSKE BANK A/S	DENMARK	AAA	A	F1	-	1.4	-	1.4
EUROPEAN INVESTMENT BANK	SUPRANATIONAL	AAA	AAA	F1+	4.8	2.3	-	7.1
EXPORT DEVELOPMENT CANADA	CANADA	AAA	AAA		-	1.1	-	1.1
FMS WERTMANAGEMENT AOER	GERMANY	AAA	AAA	F1+	-	1.8	-	1.8
GLOBAL TREAS FUNDS - MMF	GLOBAL	AAA	AAA		-	-	21.8	21.8
HSBC BANK PLC	GREAT BRITAIN	AA+	AA-	F1+	-	1.3	-	1.3
ING BANK NV	NETHERLANDS	AAA	A+	F1	-	1.4	-	1.4
INTERNATIONAL BANK FOR RECON 8	SUPRANATIONAL	AAA	AAA	F1+	-	2.0	-	2.0
INTERNATIONAL SECURITY FUND - M	GLOBAL	AAA	AAA		-	-	28.9	28.9
JPMORGAN CHASE & CO	UNITED STATES	AAA	AA-	F1+	-	1.4	-	1.4
LLOYDS TSB BANK PLC	GREAT BRITAIN	AA+	A+	F1	3.0	1.4	-	4.4
NATIONAL AUSTRALIA BANK LTD	AUSTRALIA	AAA	AA-	F1+	2.0	1.5	-	3.5
NATIONWIDE BUILDING SOCIETY	GREAT BRITAIN	AA+	A	F1	-	2.3	-	2.3
NEDERLANDSE WATERSCHAPSBANK	NETHERLANDS	AAA	AAA		-	1.5	-	1.5
NORDEA EIENDOMSKREDITT AS	NORWAY	AAA	AA-	F1+	-	1.4	-	1.4
ROYAL BANK OF CANADA	CANADA	AAA	AA	F1+	2.0	1.4	-	3.4
SKANDINAVISKA ENSKILDA BANKEN	SWEDEN	AAA	AAA		-	1.4	-	1.4
SOCIETE GENERALE	FRANCE	AA	A	F1	5.0	2.3	-	7.3
STANDARD CHARTERED BANK	GREAT BRITAIN	AA+	A+	F1	1.0	-	-	1.0
SWEDBANK HYPOTEK AB	SWEDEN	AAA	AAA		-	1.4	-	1.4
TORONTO-DOMINION BANK	CANADA	AAA	AA-	F1+	3.0	1.4	-	4.4
UBS LONDON	SWITZERLAND	AAA	A	F1	4.5	-	-	4.5
UNITED KINGDOM TBILLS	GREAT BRITAIN	AA+	AA+	F1+	-	0.9	-	0.9
Grand Total					**46.6**	**46.7**	**50.7**	**144.0**

INVESTMENT MATURITY PROFILE AND CREDIT RATING 31 MARCH 2016				
Year Band	**A**	**AA**	**AAA**	**Grand Total**
Less than 1 year	27%	13%	41%	81%
1-2 years	3%	4%	2%	9%
2-5 years	1%	4%	5%	10%
Grand Total	**31%**	**21%**	**48%**	**100%**

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

Prudential Indicators - Actuals

19. 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 2015-16 indicators were agreed in February 2015, before the start of the year and enabled the strategic director of finance and governance to carry out his responsibilities in this area. 2015-16 Prudential Indicator outturn details are included at Appendix 1.

20. The council has complied with all of its Prudential Indicators for 2015-16.

Impact of the European Union membership referendum

21. The council's treasury management strategy follows the CIPFA principles of preservation of capital and liquidity over yield and this approach protects the council's cash position. In the run up to the EU referendum we reviewed the council's investments in consultation with our advisors, Arlingclose, and with both our fund managers in the context of potential scenarios arising from both possible outcomes.

22. Whilst the Fund Managers have taken some positive actions in the run up to the referendum in order to hedge risk and position portfolios appropriately (for example shorter durations, diversified counterparties and sovereigns, increased holdings of index linked securities), no specific changes to the implementation of the approved Strategy were considered necessary.

23. Following the vote to leave the European Union, there has been turbulence in UK and European markets. This immediate volatility is expected to continue into the medium term and it is probable that there will be a weakening of the UK economy. However, the long term effects are still uncertain, and may be less severe than many suggest. The political and economic fall-out together with the situation in the markets will continue to evolve over the coming weeks, months and years. However, the current treasury investment strategy remains prudent and continues to protect our overall cash position. Our treasury advisers are not proposing any immediate change to the overall strategy.

SUPPLEMENTAL ADVICE FROM OTHER OFFICERS

Director of Law and Democracy

24. 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.

25. 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.

26. 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.

27. 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.

28. 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 – 2015-16 Actuals

AUDIT TRAIL

Lead Officer	Duncan Whitfield, Strategic Director of Finance and Governance	
Report Author	Jennifer Seeley, Director of Finance	
Version	Final	
Version Date	29 June 2016	
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		30 June 2016

APPENDIX A

PRUDENTIAL INDICATORS: 2015-16 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 2015-16 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.

2014-15	**2015-16**	
		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.
24%	10%	HRA
8%	6%	General Fund
		Incremental Impact of Capital Spend - a measure of the effect of capital plans on council tax and rents. All capital spend in 2015-16 was contained within existing resources.
-	-	Weekly rents
-	-	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 2015-16 on account of cash balances, internal borrowing and PFI transactions.
£792m	£776m	CFR
£475m	£469m	Maximum Gross Debt in the Year

INDICATORS ON CAPITAL FINANCE

4. The indicators below are for capital finance.

2014-15	2015-16	
		Capital Expenditure - capital expenditure includes PFI funded spend.
£169m	£244m	HRA
£101m	£73m	General Fund
£270m	**£317m**	**Total**
		Capital Financing Requirement (CFR) - the CFR is the balance on past capital expenditure financed through borrowing and long term liabilities (e.g. PFI).
£401m	£393m	HRA
£391m	£383m	GF
£792m	**£776m**	**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
£401m	£393m	Actual HRA CFR

INDICATORS ON TREASURY MANAGEMENT

5. The indicators below are for treasury management.

2014-15	2015-16 Limit	2015-16 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 taken on and as the council was able to access internal cash in place of borrowing, it remained below the limits throughout 2015-16.
			Operational Boundary
£475m	£705m	£469m	Borrowing (Maximum Outstanding in Year)
£114m	£120m	£114m	Other Long Term Liabilities
£589m	**£825m**	**£583m**	**Total**
			Authorised Limit
£475m	£740m	£469m	Borrowing (Maximum Outstanding in Year)
£114m	£125m	£114m	Other Long Term Liabilities
£589m	**£865m**	**£583m**	**Total**

2014-15	2015-16 Limit	2015-16 Outturn	
65%	100%	69%	**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.
£475m	£740m	£469m	Fixed rate debt
£0m	£185m	£0m	Variable rate debt
			Maturity Structure of Borrowing limits accommodating existing positions with flexibility to vary exposure within a risk controlled framework.
0%	20%	1%	Under 1 year
0%	20%	1%	1 year and within 2 years
0%	30%	7%	2 years and within 5 years
0%	40%	21%	5 years and within 10 years
0%	50%	28%	10 years and within 20 years
0%	50%	1%	20 years and within 30 years
0%	50%	37%	30 years and within 40 years
0%	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.
15%	50%	19%	Percentage longer than one year
8 Months	2 years	8 months	Overall maximum average maturity