Derby City Council

COUNCIL CABINET
9 November 2016

ITEM 15

Report of Leader of the Council

Treasury Management Mid-Year Report 2016/17

SUMMARY

1.1 This report outlines the treasury management activity for the period 1 April 2016 to 30 September 2016, which the Council is required to report under the Chartered Institute of Public Finance and Accountancy - CIPFA - Code of Practice of Treasury Management Activity, comprising:

- Summary of the Financial Markets to date in 2016/17
- Forecast Outturn 2016/17
- Borrowing Activity
- Deposits
- Prudential Indicators.

1.2 The forecast outturn for the Treasury Management activity 2016/17 is expected to be around £15m. This is a further £700,000 forecast saving in addition to the £2m reported to cabinet on the 5th October 2016 as part of the Period 4 Revenue Budget Monitoring 2016/17. The forecast savings are the result of efficiencies generated from changes to the MRP policy and additional service financing budgets to be transferred.

1.3 Treasury Management advice to the Council up to 30 September 2016 has been provided by Arlingclose. Following a tender process, TradeRisks have been appointed as our new Treasury Management Advisors from 1 October 2016. The service provided by Treasury Management Advisors includes economic and interest rate forecasting, advice on strategy, portfolio structure, debt restructuring, investment policy and credit ratings and technical assistance on other treasury matters as and when required.

RECOMMENDATION

2.1 To note the progress report on Treasury Management Activity and compliance with the Prudential Indicators for the period 1 April 2016 to 30 September 2016.

REASONS FOR RECOMMENDATION

3.1 In accordance with CIPFA Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code"), it is considered good Treasury Management practice for members to note the progress and monitor performance at least twice a year. This report covers the progress of this activity.

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Report of the Chief Executive

SUPPORTING INFORMATION

4. **The Financial Markets to date in 2016/17**

4.1 The Bank of England's Monetary Policy Committee cut the bank rate to 0.25% from 0.5% in August 2016 and signalled that rates could be reduced further if the economic outlook worsens. TradeRisks latest interest rate prediction is that they expect it to remain 0.25%. This is due to better than expected economic data since the referendum which has led to speculation that a further cut in rates is unlikely.

4.2 As a result of the bank interest rate cut the interest rates available on investments has also reduced. This reduces the level of interest the authority receives on its investments. If the bank rate is cut further, the interest rate on investments will also reduce.

4.3 PWLB rates have fallen in the year to date due to the uncertainty surrounding the referendum and the exit from the European Union. They are expected to remain low.

5. Forecast Outturn 2016/17

5.1 The forecast outturn for the Treasury Management activity 2016/17 is expected to be around £15m. This is a further £700,000 forecast saving in addition to the £2m reported to cabinet on the 5th October 2016 as part of the Period 4 Revenue Budget Monitoring 2016/17. The forecast savings are the result of efficiencies generated from changes to the MRP policy and additional service financing budgets to be transferred.

6. Borrowing Activity

6.1 The Council's 2016/17 mid-year borrowing position stands at £338.213m as shown In Table 1 below:

Table 1 – External Borrowing Debt at 30 September 2016

External Borrowing	**£**
Fixed Rate PWLB	280,117,596
Fixed Rate Market (LOBO)	20,000,000
Other Local Authorities	35,000,000
Local Enterprise Partnership (LEP)	519,039
University of Derby	1,000,000
Growing Places	1,576,329
Total External Borrowing debt at 31 March 2016	**338,212,964**

6.2 The LEP, University of Derby and Growing Places loans were loans for regeneration projects offered at favourable rates.

6.3 The maturity profile of all borrowing and average weighted interest rates are shown in the Table 2 below:

Table 2 – Borrowing Position

Period remaining as at 30 September 2016	**%**	**£000**
Under 1 year	1.94	744
1 - 2 years	2.25	12,090
2 - 3 years	3.84	10,688
3 - 4 years	1.94	702
4 - 5 years	1.94	630
5 - 10 years	4.47	23,476
10 - 20 years	4.66	52,106
20 - 30 years	4.51	17,997
30 - 40 years	4.49	167,287
40 - 50 years	4.09	52,491
Total	**4.26**	**338,213**

6.4 The Council will continue to adopt a prudent and considered approach to obtaining funding. Whilst many banks and other local authorities, offer loans equivalent to long-dated PWLB options, the PWLB continues to remain an attractive source of long-term borrowing for the Council, as it offers flexibility and control. The Council qualifies for borrowing at the PWLB 'Certainty Rate', which allows the Council to borrow at a reduction of 20 basis points (bps) on the standard rate, equivalent to a 0.2% reduction.

6.5 Treasury Management officers will continue to regularly monitor the rates from other local authorities and the PWLB for future borrowing as these continue to be a factor in the management of interest rate risk. Any decisions regarding early repayment of debt will be taken in conjunction with advice from the Councils treasury advisors. Any borrowing will be with approval from the Director of Finance.

7. Deposit Activity

7.1 In accordance with the CIPFA Code of Practice the primary objective of the Council's investment strategy remains that of obtaining the best rate of return whilst maintaining effective control of associated risks as advised by the Council's treasury advisors. In the context of the various financial markets and current economic situation, only the most secure and most liquid investments were considered. These were limited to institutions on the Council's approved lending lists and resulted in a narrowing of investment opportunities to a highly prudent position.

7.2 The Council has placed its deposits in 2016/17 to date in accordance with the Treasury Management Strategy approved in February 2016, and professional guidance from our Treasury Advisors, who consistently review the financial markets and update the Council accordingly.

7.3 The level of deposits for 1 April to 30 Sept 2016 is shown in Table 3 below:

Table 3 – Level of Deposit Activity 1 April 2016 to 30 Sept 2016

Value of deposits held at 31 March 2016	£69,120,889
Value of deposits held at 30 September 2016	£77,170,521
Average size of portfolio 2015/16	£82,499,000
Average size of portfolio 1 April to September 2016	£87,892,000
Total interest earned on deposits April to Sept 2016	£206,668
Total Interest earned on deposits April to Sept 2015 for comparative purposes	£182,572
Total interest earned on deposits 2015/16	£415,730
Average Interest Rate earned 2016/17 to date	0.44%
Number of fixed-term deposits made:	14
Number of instant access accounts used:	15
Deposits/withdrawals from instant access/ call accounts:	19

7.4 The current level of interest earned on deposits April to Sept 2016 shown above, is greater than the interest earned in April to Sept 2015, this is due to the average size of the portfolio for April to September 2016 being greater than in 2015/16.

7.5 It should be noted, that as the Bank of England's Monetary Policy Committee cut the Bank Rate to 0.25% in August 2016, the interest rates available on investments has also fallen. It is anticipated the average rate earned on investment for the full year 2016/17 will fall from the average interest rate earned April to September 2016 of 0.44% and it is expected less interest overall will be earned in 2016/17 than in 2015/16.

7.6 The interest earned on instants access and call account deposits is from a range of banks and money market funds (MMF) which are detailed below. The average interest rate on these deposits to date was 0.41% The Council also had the option to deposit with the Debt Management Office (DMO). This however would only pay a fixed interest amount on deposits of 0.15%.

7.7 The call accounts used all have fixed rates in 2016/17. The rates were at or above 0.40% until mid August 2016 but have been reduced to current rates of 0.10% or 0.15%. MMF's have variable rates. To date 0.45% has been earned on average on MMF's. Both the call accounts and MMF provided instant access to the deposits. The list of recommended banks and money market funds used were as follows:

- Standard Life Investments
- Aberdeen Asset Management
- Black Rock
- Federated Investors (UK) LLP
- Invesco AIM
- Goldman Sachs
- State Street
- Legal & General
- Insight
- Santander
- Royal Bank of Scotland
- Bank of Scotland
- Barclays
- Public Sector Deposit Fund
- Svenska - Handelsbanken

7.8 The fixed term deposits undertaken to date have been with 6 Local Authorities and Nationwide Building Society. All fixed term deposits were at a favourable rate higher than instant access accounts. The average interest earned to date on fixed term deposits is 0.50%.

7.9 Bail-in legislation means that large investors including local authorities will rescue failing banks instead of taxpayers in the future. Call accounts and Money Market Funds are subject to bail-in. Fixed term deposits with local Authorities are not subject to bail-in, and there is an insignificant risk of insolvency. Therefore this year to date when appropriate more fixed term deposits with Local Authorities have been undertaken to protect against the higher credit risk of unsecured bank deposits. There is no limit on the overall value or percentage of the investment portfolio that can be held in fixed term deposits, however a minimum limit of £20m must be held in instant access accounts.

7.10 The maximum deposit allowed with individual MMF is 0.50% of the overall fund size as advised by our Treasury Advisors to a maximum of £8m. There is also a limit that only 50% of the Council's investment portfolio can be held in MMF's. The maximum limits for other Counterparties are set at £12m. These limits were approved in the Treasury Management Strategy 2016/17 and are constantly reviewed by our Treasury Advisors and the Council is advised accordingly. Activity in year has been within these limits.

7.11 The Councils bank Lloyds is used for daily operational banking purposes and also short term liquidity requirements (overnight and weekend investments). In addition, the Council also receive from Lloyds Bank interest earned on the balances held. The formally approved maximum limit to be held as approved in the Treasury Management Strategy 2016/17 is currently £15m.

8. The Prudential Code and Indictors

8.1 Following the Local Government Act 2003, the Prudential Code requires that the Council adopts a set of annual prudential indicators relating to capital expenditure and treasury management. The key objectives of the Prudential Code are to ensure that the capital investment plans are affordable, prudent and sustainable.

8.2 The prudential indicators adopted by the Council relate to:

- affordability, specifically with reference to the impact of the capital programme on council tax
- prudence, comparing actual Council borrowing with its need to borrow
- capital expenditure, highlighting the planned expenditure of the Council and its impact on the need to borrow
- external debt, specifying the limit determined by Council above which further borrowing is not permitted
- treasury management, outlining the limits relating to interest rate exposure and principal exposure on both investments and borrowing.

9. Affordability Indicator

9.1. The ‘affordability’ indicator within the Prudential Code is intended to measure the percentage of the Council’s revenue impact of total income that it is estimated will be committed towards meeting the costs of borrowing used to fund capital expenditure. The Prudential Code does not recommend that any upper limit be placed on this ratio. However, it does state that the objective of the indicator is to ensure that “the total capital investment of the authority remains within sustainable limits”.

9.2 The Prudential Code requires that a ratio of net financing costs to the net revenue stream be produced to measure the relative cost of maintaining debt year-on-year. This is a key affordability indicator and shows the long-term trend of financing costs, which is basically, the cost of maintaining debt less any investment income from cash balances. Based on the current year 2015/16 capital position, the projected indicators for Derby’s General Fund (GF) and Housing Revenue Account (HRA), with the previous outturn 2015/16 figures for comparison, are shown in Table 4 below.

Table 4 – Affordability Indicator

	General Fund	**HRA**
2015/16 Actual	6.31%	19.70%
2016/17 To date	6.62%	19.25%

9.3 The increase in the general fund reflects the reducing levels of overall funding and levels of income to the Council. The decrease in the HRA represents an increase in the HRA net revenue stream from 2015/16 to 2016/17.

10. Prudence Indicator

10.1 Prudence relates to the extent of the Council’s borrowing amount needed against its actual borrowing requirement, usually referred to as the Capital Financing Requirement – CFR.

10.2 A large proportion of the Council cash balances in 2016/17 have continued to be used to temporarily postpone the need to take on external debt, reducing risk and at the same time making short-term revenue savings.

10.3 The Council’s Treasury Management budget still continues to be based on the assumption that the Council will on a rolling basis borrow less than required by the capital programme, referred to as ‘under borrowing’. The assumption being that the Council’s cash balances will provide temporary funding until the borrowing is actually undertaken at a later date.

10.4 The Prudential Code requires a comparison between total net external borrowing and the Council’s CFR. This is to ensure that overall external borrowing exposure is not excessive. The requirement of the code is that external borrowing, net of any investments, should not exceed the CFR at the end of the final year of a three year programme.

10.5 The CFR for 2016/17 to date and 2015/16 are shown in Table 5 below:

Table 5 – Capital Financing Requirement

	GF	HRA	Total
	£m	£m	£m
2015/16 Actual	402.5	230.9	633.4
2016/17 to date	407.9	230.9	638.8
Increase	5.4	0.00	5.4

Generally, an overall increase in the CFR shows the extent to which the capital programme has been financed from borrowing. The increase in the general fund reflects the increase in long term borrowing forecast to fund the capital programme. No further borrowing in respect of the HRA has been undertaken.

10.6 Table 6 below considers the prudential indicator and also the local indicator which includes debt that was transferred to the Council from Derbyshire County Council on Local Government Reorganisation in 1997.

10.7 **Table 6 – Capital Financing Requirement – Prudential & Local Indicators**

	Actual 2015/16 £m	Estimate 2016/17 to date £m
Prudential Indicator		
- Gross External Debt	434.0	429.4
- Investment Balances	(69.1)	(69.1)
- Net External Debt	364.9	360.3
- CFR	633.4	638.8
- Variance	(268.5)	(278.5)
Local Indicator		
- Gross External Debt	434.0	429.4
- Transferred Debt	31.0	29.8
- Investment Balances	(69.1)	(69.1)
- Net External Debt	395.9	390.1
- CFR	633.4	638.8
- Variance	(237.5)	(248.7)

The estimate for the prudential indicator at 31 March 2017 shows net external debt of £390,100,000 well below the estimated CFR of £638,800,000 as at 31March 2017. The variance of £248,700,000 in the indicator is the difference between the amount we would have borrowed if all of our unsupported capital expenditure had been financed by borrowing and the amount we have actually borrowed. This effectively means that the council has under borrowed and utilised cash balances instead of borrowing.

11. Capital Expenditure and Borrowing Indicator

11.1 The quarter 2 position for capital is reported to Cabinet in the Capital Monitoring Quarter 2 Report. The actual prudential indicators consistent with the current capital position are related to the borrowing element of the capital programme. The current element of the borrowing to date in 2016/17 is shown against the overall percentage for 2015/16.

Table 7 – Capital Expenditure and Borrowing Indicator

	General Fund (GF)	Housing Revenue Account (HRA)	Total
	£m	£m	£m
Capital expenditure to date in 2016/17	51.0	14.9	65.9
of which – borrowing	18.9	0	18.9
of which – other sources	32.1	14.9	47.0
Borrowing percentage	**37%**	**0%**	**29%**
Capital expenditure 15/16	51.9	18.3	70.2
of which – borrowing	14.2	0.0	14.2
of which – other sources	37.7	18.3	56.0
Borrowing percentage	**27%**	**0%**	**20%**

11.2 Table 7 shows the an increase of 10% in the borrowing percentage to date and the proportion of the capital programme funded by borrowing in comparison to 2015/16 for General Fund. This increase is due to more borrowing being required as less funding has been secured from other sources in 2016/17.

12. External Debt and Borrowing Limits Indicator

12.1 Section 3 of the 2003 Local Government Act imposes a duty on the Council to set a limit on how much money it can afford to borrow and to keep this under review. The ‘authorised limit’ is the affordable borrowing limit of which the Council does not have the power to borrow above this level. This is the maximum amount of debt that the Council can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

12.2 Additionally, the Council must set an 'operational boundary' for borrowing. This is based on the Councils estimate of most likely, i.e. prudent, but not worst case scenario of external debt. Periods where the actual position is either below or over the boundary are acceptable providing the authorised limit is not breached. These targets are required to be set on a 'rolling' three-year basis.

12.3 In line with paragraph 12.1, the Council's operational boundary and authorised limit for 2016/17 are £681,000,000 and £751,000,000 respectively. The current estimated external borrowing plus transferred debt as at 31/03/2017 is £459,200,000. This is within the operational boundary and within the authorised limit and indicates that the Council has not breached its borrowing limits.

13. Treasury Management indicators

13.1 The Council measures and manages its exposures to treasury management risks using the following indicators. These indicators were approved in the Treasury Management Strategy 2016/17 by Cabinet in February 2016.

13.2 **Security:** The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit score of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

13.3 Local Authorities are unrated, therefore fixed term deposits with Local Authorities have to be assigned a score. The score assigned is AAA=1, this means the investments are of the highest credit quality. This is due to Local Authorities not being subject to bail-in and having an insignificant risk of insolvency.

13.4 Table 8 shows the target for the portfolio average credit score and the actual as at 30 September 2016.

Table 8 – Security Indicator - Portfolio average credit score

	Target	**Actual**
Portfolio average credit score	3.00	1.20

The actual credit score is below the target showing the exposure to credit risk in the year to date achieved has been lower than the target set this is due to higher credit quality investment being used over lower credit quality investment. This is due to the increase use of fixed term deposits with Local Authorities.

13.5 **Maturity Structure of Borrowing -** The actual maturity structure of borrowing as at 30 September 2016 has been compared to the loan maturity limit profile that was approved in the Treasury Management Strategy 2016. Table 9 below shows that this indicator has been met as follows:

Table 9 - Debt Maturity Indicator

Duration	Limit %	Actual %
Up to 1 year	15	0.22
Up to 2 years	20	3.79
Up to 5 years	30	7.35
Up to 10 years	50	14.29
Up to 20 years	70	29.70
Up to 30 years	80	35.02
Up to 40 years	90	84.48
Up to 50 years	100	100.00

13.6 **Principal Sums Invested for Periods Longer than 364 days** -The final treasury management indicator required relates to the limit at any one time on investments with a period to maturity of no greater than 365 days. Investments made in 2016/17 to date were in accordance with this criteria and no investment has been made greater than 365 days.

13.7 The other locally-set prudential indicator required for Treasury Management relates to interest rate exposure which allows the Council to manage the extent to which it is exposed to changes in interest rates. It also shows the split of borrowing between fixed and variable rates. Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole of the financial year. Instruments that also mature in the financial year are classed as variable.

The split in respect of borrowing as at 30 September 2016, and the comparative figures for the previous year, are shown in Table 10:

Table 10 – Interest Rate Exposure Indicator

	2016/17 to date		2015/16	
	Upper limit %	Actual to 30/09/16 %	Upper Limit %	Actual 31/03/16 %
Interest Rate Exposure - Fixed	100	84.18	100	84.27
Interest Rate Exposure - Variable	20	15.82	20	15.73

13.8 These figures show that the Council has not exceeded the limits for undertaking fixed and variable debt.

13.9 It is still not advisable for the Council to fix all of its borrowing in the immediate future. This is because borrowing rates still outweigh investment rates, leading to a heavy 'cost of carry' which the Council would have to bear in its revenue budget. It therefore still remains largely preferable for the Council to continue to be in a state of readiness to borrow if it looks like borrowing rates are likely to rise quickly. Our Treasury Advisors are providing regular advice and interest rate forecasts to assist the Council in this area.

14. OTHER OPTIONS CONSIDERED

14.1 None considered.

This report has been approved by the following officers:

Legal officer **Financial officer** **Human Resources officer** **Estates/Property officer** **Service Director(s)** **Other(s)**	 Toni Nash, Head of Finance Martyn Marples, Director of Finance & Procurement

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Background papers:	None
List of appendices:	Appendix 1 – Implications

Appendix 1

IMPLICATIONS

Financial and Value for Money

1.1 As described in the report.

Legal

2.1 None.

Personnel

3.1 None directly arising.

IT

4.1 None.

Equalities Impact

5.1 None directly arising.

Health and Safety

6.1 None.

Environmental Sustainability

7.1 None.

Property and Asset Management

8.1 None.

Risk Management

9.1 None directly arising

Corporate objectives and priorities for change

10.1 None.