COUNCIL CABINET
11 November 2015

ITEM 14

Report of Leader of the Council

Treasury Management Mid-Year Report 2015/16

SUMMARY

1.1 This report outlines the treasury management activity for the period 1 April 2015 to 30 September 2015, 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:

- a Summary of the Financial Markets to date in 2015/16
- Forecast Outturn 2015/16
- Borrowing Activity
- Deposits
- Prudential Indicators.

1.2 The forecast outturn for the Treasury Management activity 2015/16 is expected to be around £15,000,000 with a further forecast outturn underspend of £800,000 in addition to the £6,000,000 already transferred to the budget risk reserve earlier in the year. It is proposed to transfer the further underspend to the Budget Risk Reserve to support future budget planning risks and general unforeseen in-year pressures.

1.3 Treasury Management advice to the Council continues to be provided by Arlingclose. The service provided 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 2015 to 30 September 2015.

2.2 To approve the changes to the investment activity as detailed in Appendix 2.

2.3 To approve the transfer of £800,000 to the budget risk reserve.

2.4 To approve the use of Variable Net Asset Value Money Market Funds (VNAV MMF) as detailed in Appendix 2 and to approve the increase the limit of fixed term deposits from £30m to £40m also detailed in appendix 2.

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.

3.2 To comply with the Council's Financial Procedure Rules regarding transfers to reserves.

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Derby City Council

Report of the Chief Executive

SUPPORTING INFORMATION

4. **The Financial Markets to date in 2015/16**

4.1 There has been no change to the UK monetary policy with official interest rates being maintained at 0.5% by the Bank of England. Arlingclose however expects interest rates to rise slower and by less than the market is predicting with a predicted Base Rate rise in March 2016.

5. Forecast Outturn 2015/16

5.1 The Treasury Management activity 2015/16 is expecting an outturn of around £15,000,000.This is a forecast underspend of £800,000 in addition to the £6,000,000 already declared at quarter 1. It is proposed the £800,000 is transferred to the Budget Risk Reserve to support future budget planning risks and general unforeseen in-year pressures. This underspend is due to the one off BSF charge to be vired at outturn together with some further new 2015/16 virements still to be actioned.

6. Borrowing Activity

6.1 The Council's 2015/16 mid-year borrowing position stands at £332.170m. This is made up of Public Works Loans Board - PWLB - loans of £276.629m, £20m loans from the Royal Bank of Scotland, £35m borrowed from other Local Authorities and £520k from the Local Enterprise Partnership - LEP. The maturity profile of all borrowing and average weighted interest rates are shown in the Table 1 below:

Table 1 – Borrowing Position

Period remaining as at 30 September 2015	%	£000
Under 1 year	0	0
1 - 2 years	0.0	0
2 - 3 years	0.0	0
3 - 4 years	3.045	20,000
4 - 5 years	0.0	0
5 - 10 years	4.15	19,541
10 - 20 years	4.58	53,409
20 - 30 years	4.09	17,223
30 - 40 years	4.47	118,242
40 - 50 years	4.42	103,755
Total		**332,170**

6.2 Whilst many banks and other local authorities, offer loans equivalent to long-dated PWLB options, the Council will continue to adopt a prudent and considered approach to obtaining funding. For longer term borrowing, the PWLB continues to remain an attractive source of borrowing for the Council, as it offers flexibility and control. Treasury Management officers will continue to regularly monitor PWLB rates and borrow at the appropriate time with approval from the Director of Finance. 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.

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. 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 2015/16 to date in accordance with the Treasury Management Strategy approved in February 2015, and professional guidance from Arlingclose, who consistently review the financial markets and update the Council accordingly.

7.3 The level of deposits for 1 April to 30 Sept 2015 is shown in Table 2 below:

Table 2 – Level of Deposit Activity 1 April 2015 to 30 Sept 2015

Value of deposits held at 31 March 2015	£45,015,806
Value of deposits held at 30 September 2015	£79,773,000
Average size of portfolio 2014/15	£68,312,000
Average size of portfolio 1 April to September 2015	£81,037,000
Total interest earned on deposits April to Sept 2015	£182,572
Total Interest earned on deposits April to Sept 2014 for comparative purposes	£183,000
Total interest earned on deposits 2014/15	£361,000
Average Interest Rate earned 2015/16 to date	0.44%
Number of fixed-term deposits made:	11
Number of instant access accounts used:	13
Deposits/withdrawals from instant access/ call accounts:	50

Based on the current level of interest earned on deposits April to Sept 2015 shown above, compared to April to Sept 2014, it is anticipated that we are on target to achieve the same level of interest earned 2015/16 compared to 2014/15. However, it should be noted, that this is dependent on yield, and as the advice from Arlingclose is now more diversification of deposits, the further spread of investments may not all generate the same rate of return.

7.4 The interest earned on deposits is from a range of banks and money markets which are detailed below. The average interest rate on these deposits to date was 0.46% 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 0.25%.

7.5 The fixed term deposits were with 3 Local Authorities, Barclays and Nationwide. All fixed term deposits were at a favourable rate higher than instant access accounts, however in order to diversify the range of deposits held, these have been limited to a percentage of the overall portfolio since April 2014.

7.6 The Council also frequently uses call accounts, which all had fixed rates in 2015/16 to date of above 0.44%, and money market funds - MMF - which have variable rates of 0.47% on average to date. 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

7.7 The size of the maximum deposit allowed in each of the above institutions is dependent on the overall fund size as agreed as part of the Annual Strategy report approved in February 2015, shown in Appendix 2. This activity has been undertaken in accordance with advice from Arlingclose. Whilst the maximum limits per Counterparty are set at £12m, these are constantly reviewed by Arlingclose and the Council is advised accordingly.

7.8 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 2015/16 is currently £15m. As the Lloyds Bank Account is a daily operational bank account, it should be noted that this may go over the recommended portfolio size of 10% per counterparty, in particular around the salary payment day at the end of the month. This will only be on an adhoc and overnight basis.

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.

8.3 Further details of each indicator at the end of 2014/15 together with the 2015/16 half year forecasts are as follows:

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 2014/15 capital position, the projected indicators for Derby’s General Fund (GF) and Housing Revenue Account (HRA), with the previous outturn 2014/15 figures for comparison, are shown in Table 3 below.

Table 3 – Affordability Indicator

	General Fund	HRA
2014/15 Actual	7.12%	17.69%
2015/16 To date	6.74%	17.81%

9.3 The decrease in the general fund reflects the reducing levels of overall funding and levels of income to the Council.

10. Prudence Indicator

10.1 Prudence relates to the extent of Council 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 2015/16 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 2015/16 to date and 2014/15 are shown in Table 4 below:

Table 4 – Capital Financing Requirement

	GF	**HRA**	**Total**
	£m	£m	£m
2014/15 Actual	353.9	229.7	583.6
2015/16 to date	385.7	230.9	616.5
Increase	31.8	1.20	32.9

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 5 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 5 – Capital Financing Requirement – Prudential & Local Indicators

	Actual 2014/15 £m	Estimate 2015/16 to date £m
Prudential Indicator		
- Gross External Debt	432.6	427.4
- Investment Balances	(45.0)	(30.0)
- Net External Debt	387.60	397.4
- CFR	583.6	616.5
- Variance	(196.0)	(219.1)
Local Indicator		
- Gross External Debt	432.6	427.4
- Transferred Debt	32.3	31.0
- Investment Balances	(45.0)	(30.0)
- Net External Debt	419.9	428.4
- CFR	583.6	616.5
- Variance	(163.7)	(188.1)

11. Capital Expenditure and Borrowing Indicator

11.1 The mid-year/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 2015/16 is shown against the overall percentage for 2014/15.

Table 6 – Capital Expenditure and Borrowing Indicator

	General Fund (GF)	Housing Revenue Account (HRA)	Total
	£m	£m	£m
Capital expenditure to date in 2015/16	72.7	19.7	92.4
of which – borrowing	32.8	0	32.8
of which – other sources	39.9	19.7	59.6
Borrowing percentage	**45%**	**0%**	**35%**
Capital expenditure 14/15	85.50	13.3	98.8
of which – borrowing	40.0	0.0	40.0
of which – other sources	45.5	13.3	58.8
Borrowing percentage	**47%**	**0%**	**40%**

11.2 Table 6 shows a decrease of 2% in the borrowing percentage to date and the proportion of the capital programme funded by borrowing in comparison to 2014/15. This decrease is mainly due to a reduced capital programme and borrowing requirement for 2015/16.

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, above, in February 2015 as part of the 2015/16 strategy report the Council's operational boundary and authorised limit for 2015/16 were set at £668,000,000 and £738,000,000 respectively. The current external borrowing plus transferred debt is £360,365,859. 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 Interest rate exposure indicator

13.1 The other locally-set prudential indicator required for Treasury Management relate to interest rate exposure which allow 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 2015, and the comparative figures for the previous year, are shown in Table 7:

13.2 **Table 7**

	2015/16 to date		2014/15	
	%	Actual to 30/09/15 %	%	Actual 31/03/15 %
Upper Limit	100		100	
Interest Rate Exposure - Fixed		92.46		89.21
Interest Rate Exposure - Variable		7.54		10.79

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

13.4 The future borrowing will be a combination of local authority borrowing and borrowing from the PWLB.

13.5 It is still not advisable for the Council to fix all of its borrowing in the immediate future. This is because borrowing rates still greatly outweigh investment rates, lending 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. Arlingclose are providing regular advice and interest rate forecasts to assist the Council in this area.

13.6 One of the treasury management indicators, relates to the current loan maturity limit profile, approved by Cabinet in February 2015 which should then be compared with the actual structure of borrowing as at 30 September 2015. Table 8 below shows that this indicator has been met as follows:

Table 8

Duration	Limit %	Actual %
Up to 1 year	15	5
Up to 2 years	20	10
Up to 5 years	25	20
Up to 10 years	50	50
Up to 20 years	70	70
Up to 30 years	80	80
Up to 40 years	90	90
Up to 50 years	100	100

13.7 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 2015/16 to date were in accordance with this criteria and no investment has been made greater than 365 days.

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)**	 Amanda Fletcher

For more information contact:	Nicola Goodacre Group Accountant 01332 643352 nicola.goodacre@derby.gov.uk
Background papers:	None
List of appendices:	Appendix 1 – Implications Appendix 2 – Recommended Counterparty List

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.

Recommended Counterparty List
Appendix 2

1 Recommended Counterparties and Limits

1.1 The grouping of counterparties and limits agreed per institution as part of the Annual Strategy Report in February 2015 are shown in Table 1 below.

Table 1 – Counterparties and Limits approved – February 2015

Counterparty	Max Period	Limit
Long term BBB+/A-	**I Year**	
Bank of England Debt Management Office	**6 months**	
Money Market Funds – Call Accounts	**n/a**	**0.50% of fund size to a max of £10m**
MMF (VNAV) Notice Accounts	**1 Year**	
Other Local Authorities	**1 Year**	**£15m**
Main bank contract	**Overnight**	**£15m**

1.2 Following the inclusion of building societies and European banks, and further advice from Arlingclose, regarding other options in order to diversify the range and type of investments, whilst the maximum deposit limit cannot exceed £12m, it has been recommended that the individual counterparties and their deposits are kept to a maximum of 10% of the overall portfolio. A further option the Council wish to undertake on the advice of Arlingclose would be the inclusion of notice accounts (VNAV) variable rate accounts with MMF which return a higher yield with a low risk and low volatility. In order to do this the overall limit with each MMF would be increased to allow the flexibility to invest in both MMF call accounts and MMF notice accounts.

1.3 Currently fixed term deposits have a monetary limit of no more than £30m allowable to be fixed at any one time. Fixed term deposits enable the council to better plan for large payments such as pay day therefore it would seem prudent to increase the limit allowable from £30m to £40m to allow more flexibility to fix deposits for a longer period.