COUNCIL CABINET
13 July 2016

ITEM 18

Report of the Leader of the Council

Treasury Management Annual Report 2015/16

SUMMARY

1.1 This report reviews how the Council conducted its borrowing and investments during 2015/16 and reports on the prudential indicator activity for 2015/16 which the Council is required to report under the Local Government Act 2003. The report includes the following:

- A summary of the financial markets 2015/16
- Treasury Management Activity and Deposits/Investments
- Borrowing and maturity profile
- Prudential Code Indicators and limits.

1.2 The Treasury Management net underspend for 2015/16 was £970,130 after prior agreed movement of £6,800,000 to reserves. This was mainly achieved following a review of the debt model, which included a review of asset lives for previous capital projects. This resulted in changes to asset lives, effectively spreading the cost of borrowing over a longer period to give a saving against budget in 2015/16. In addition investment interest earned was higher than anticipated.

1.3 The Council has a prudent approach to treasury management in that it does not borrow more than it needs, due to the cost of carry (the gap between interest paid on borrowing and interest received on investments). It only lends to approved financial institutions, and this discipline is enforced by reviewing the approved list of counterparties, which is regularly updated in consultation with the Councils treasury advisors.

1.4 The treasury management advice to the Council continues to be provided by Arlingclose who were appointed as our advisors on 1 April 2011. 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 matters as and when required. In accordance with the tender specification, this contract will expire on 30 September 2016. The tender process for the appointment of the Council's treasury management advisors from 1 October 2016 is currently in progress.

1.5 For 2015/16 all prudential indicators and limits have been adhered to.

RECOMMENDATIONS

2.1 To approve the Annual Report in respect of Treasury Management activity for 2015/16.

2.2 To note the prudential indicators in respect of the 2015/16 outturn as outlined in the report.

REASONS FOR RECOMMENDATION

3.1 In accordance with CIPFA Code of Practice for Treasury Management in Public Services (the “CIPFA TM Code”), members need to approve the annual report for Treasury Management activity in 2015/16.

3.2 Under CIPFA’s Prudential Code for Capital Finance in Local Authorities, members have a statutory duty to adopt a set of annual indicators relating to capital expenditure and treasury management.

Derby City Council

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Report of the Chief Executive

SUPPORTING INFORMATION

4. The Financial Markets During 2015/16

4.1 The information relating to the overall global position of the UK financial markets in 2015/16 was provided by our treasury advisors, who continue to update the Council with on-going market activity and interest rates.

4.2 The Bank of England maintained interest rates at 0.5% throughout 2015/16. The interest rate will continue to be monitored and members will be updated on the proposed interest rate forecasts in future treasury management reports. The Bank of England's Monetary Policy Committee is of the view that when the bank rate does begin to rise, it is expected to do so more gradually and to a lower level than in recent cycles.

5. Treasury Management Activity and Deposits/Investments

5.1 In accordance with the CIPFA Code of Practice the primary objective of the Council's investment strategy in 2015/16 remained that of obtaining the best rate of return, whilst maintaining effective control of associated risks as advised by the Councils treasury advisors. Only secure and liquid investments were considered which were with institutions on the approved counterparty lending lists. This resulted in a narrowing of investment opportunities to a highly prudent position.

5.2 Table 1 below shows the investment criteria used for the investments based on those which were in the Treasury Management Strategy 2015/16, approved by Council Cabinet on 18 February 2015. In 2015/16 all investments made by the Council, met the investment criteria shown in Table 1 below.

5.3 **Table 1 – Deposit/ Investment Criteria**

Investment Criteria in 2015/16	**Max period**	**Cash limit per counterparty/ local authority**
Banks/ Building - BBB+/A-	1 year	£12,000,000 or 10% of the overall portfolio
Money Market Funds - MMF -	n/a	0.50% of the overall portfolio to a maximum of £10,000,000
Other Local Authorities	1 year	£12,000,000
Lloyds Bank – Operational purposes	Overnight	£15,000,000

5.4 The level of investment activity in 2015/16 together with a comparison for the previous year is shown in Table 2 below:

Table 2 – Level of Investment activity

	2014/15	2015/16
Number of instant access and money market accounts used	15	15
Number of deposits/withdrawals from money market funds/ call accounts	250	188
Value of deposits/ investments held at 31 March	£45,015,806	£69,120,899
Average Size of deposit/ Investment Portfolio	£68,312,000	£82,499,000
Total interest earned on deposits/ investments	£361,522	£415,730
Average Return on deposits/ investment portfolio	0.49%	0.39%

5.5 The number of deposits and withdrawals has fallen in 2015/16 due to the Council's current bank account with Lloyds earning a higher level of interest than the interest received on some of the money market funds held, therefore reducing the number of withdrawals and deposits made with money market funds. Fixed terms investments with other Local Authorities have been utilised more during the year which has also resulting in less withdrawals and deposits being made.

5.6 The value of investments held as at 31 March and the average size of investment portfolio has increased in 2015/16, reflecting that income has been received in advance of spend. However the average return on investments achieved has fallen this reflects a reduction in the interest rates available for investments and a move to diversify the investment portfolio by using fixed term investments with other Local Authorities to reduce risk.

5.7 During 2015/16, call accounts utilised, as listed below, attracted fixed interest rates, whilst money markets utilised, as listed below, were offered at variable rates. Both the call accounts and the Money Market Funds (MMF) accounts provided instant access to the investments held. The list of banks and MMF used in 2015/16 were as follows:

Call Accounts

- Santander
- Lloyds
- Bank of Scotland
- Barclays
- Handelsbanken/Svenska

Money Markets

- Standard Life Investments (Formally IGNIS)
- Aberdeen Asset Management
- Black Rock
- Federated
- Invesco AIM
- Goldman Sachs (Formally Global Treasury Fund)
- State Street
- Legal & General
- Insight
- Public Sector Deposit Fund.

5.8 All investment decisions were taken in accordance with advice from the Council's treasury advisors who consistently reviewed the financial markets and counterparties and regularly updated the Council. The Council's deposit/ investment limit with each of these funds was dependent on the fund size, and the absolute total limit for all MMF investments remained under the maximum level of 50% of funds available.

6. Borrowing and Maturity Profile 2015/16

6.1 The level of external debt outstanding at 31 March 2016 in relation to external borrowing is shown in the table 3 below:

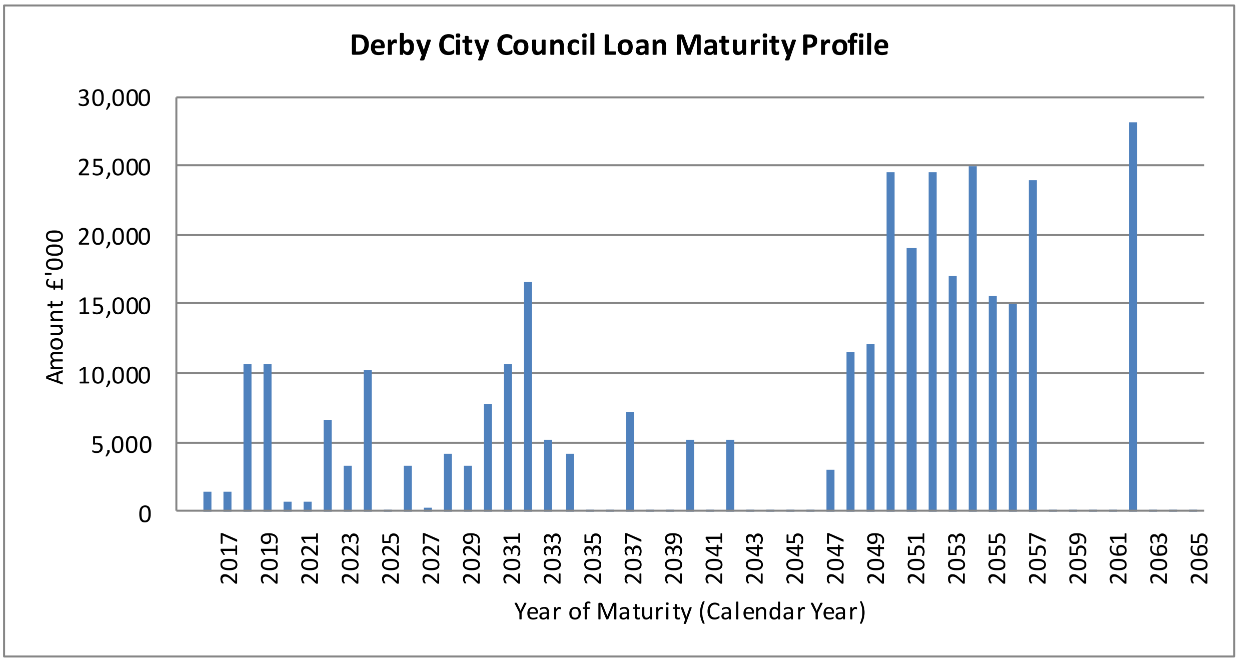
Table 3 – External Borrowing Debt at 31 March 2016

External Borrowing	£
Fixed Rate PWLB	280,672,384
Fixed Rate Market (LOBO)	20,000,000
Other Local Authorities	35,000,000
Local Enterprise Partnership	540,980
University of Derby	1,000,000
Growing Places	1,500,000
Total External Borrowing debt at 31 March 2016	**338,713,364**

6.2 The non PWLB loans undertaken in 2015/16 were loans on regeneration projects offered at favorable rates.

6.3 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. Table 4 below shows the maturity profile of the above outstanding debt. Any decisions regarding early repayment of debt will be taken in conjunction with advice from the Councils treasury advisors.

Table 4 – Loan Maturity File



7. The Prudential Code Indicators and Limits

7.1 The Local Government Act 2003, requires the Council to adopt the CIPFA Prudential Code and produce a set of indicators when determining how much money it can afford to borrow. The Prudential Code also requires that the capital investment plan of the Council is affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice.

7.2 This report includes the outturn position for the prudential indicators and reports on treasury management activity during 2015/16. It demonstrates that the Council has fulfilled the objectives of the Code.

7.3 The prudential indicators adopted by the Council relate to:

- affordability, specifically with reference to the impact of the capital programme and treasury management costs
- 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 Affordability Indicator

8.1 The ‘affordability’ indicator within the Prudential Code provides an indication of the revenue impact of the Council’s overall capital programme and how it decides to finance this.

8.2 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”.

8.3 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, basically, the cost of maintaining debt less any investment income from cash balances. Based on the capital outturn position for 2015/16, the indicators for Derby’s General Fund - GF - and Housing Revenue Account - HRA, (with the previous year’s figures shown for information) are shown in Table 5 below:

Table 5 – Affordability Indicator

	General Fund	HRA
Actual 2014/15	6.85%	20.24%
Actual 2015/16	6.31%	19.70%

8.4 The decrease in the general fund indicator reflects an increase in net revenue stream from 2014/15 to 2015/16. The decrease in the HRA indicator is due to an increase in the HRA net revenue stream from 2014/15 to 2015/16.

8.5 When the budget was set by Cabinet in February 2015 the affordability Indicator was set at 8.47% for the General Fund and 18.39% for HRA. The variance of 2.16% reflects the 2015/16 underspend on treasury management against budget reported in paragraph 1.2. The increase of 1.31% on the HRA reflects a reduction in the HRA net revenue stream against budget.

9. Prudence Indicator – Capital Financing Requirement

9.1 Prudence relates to the extent of the Councils need to borrow against its actual borrowing. The Councils borrowing requirement is commonly known as the Capital Financing Requirement - CFR.

9.2 In recent years the risks associated with holding on to high cash balances have increased, as has the differential between investment and borrowing interest rates. It has therefore been deemed sensible to use a large proportion of the Council's cash balances in 2015/16 to temporarily postpone the need to take on external debt, reducing risk and at the same time making short-term revenue savings.

9.3 The Council's treasury management budget policy continues to be based on the assumption that the Council will on a rolling basis borrow less than required by the capital programme. The assumption being that the Council's cash balances will provide temporary funding until the borrowing is actually undertaken at a later date.

9.4 The actual timing of the borrowing will be driven mainly by the Council's plans to use its cash balances, reserves, and the need to optimise our opportunities to borrow at favourable rates.

9.5 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.

9.6 The CFR for 2015/16 and 2014/15 are shown in Table 6 below:

Table 6 – Capital Financing Requirement

CFR	GF	HRA	Total
	£m	£m	£m
2014/15 Actual	359.5	229.7	589.2
2015/16 Actual	368.5	230.9	599.4
Difference	9.0	1.2	10.2

The increase in the general fund CFR reflects the increase in unsupported capital borrowing required to fund the capital programme for 2015/16 plus the increase in PFI liabilities in 2015/16 less the amount set aside to repay debt in 2015/16.

No borrowing in relation to the HRA has been undertaken in 2015/16. The small increase relates to the transfer of assets to HRA.

9.7 Table 7 sets out the prudential indicator which compares the Council's overall debt with its CFR The indicator 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.

Table 7 – Overall debt Comparison to Capital Finance Requirement

	Actual 2014/15 £m	Actual 2015/16 £m
Prudential Indicator		
- Gross External Debt	426.0	434.0
- Investment Balances	-45	-69.1
- Net External Debt	381.0	364.9
- CFR	589.2	599.4
- Variance	-208.2	-234.5
Local Indicator		
- Gross External Debt	426.0	434.0
- Transferred Debt	32.3	31.0
- Deposit/ Investment Balances	-45.0	-69.1
- Net External Debt	413.3	395.9
- CFR	589.2	599.4
- Variance	-175.9	-203.5

Gross External Debt is the total of external borrowing as at 31 March 2016 of £338,672,384 (as per Table 3) plus PFI liabilities of £95,278,266.

9.8 The prudential indicator at 31 March 2016 showed net external debt of £364,900,000 well below the current CFR of £599,400,000. The variance of £234,500,000 in the indicator is the difference between the amount we would have borrowed if all 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.

10 Capital Expenditure and Borrowing Indicator

10.1 The final capital outturn for 2015/16 is reported to Cabinet in the 2015/16 Capital Outturn Report, elsewhere on this agenda. The actual indicators, consistent with this report, split between General Fund including unsupported borrowing, and Housing Revenue Account are shown in Table 8 below.

Table 8 – Capital Expenditure and Borrowing

	General Fund (GF)	Housing Revenue Account (HRA)	Total
	£m	£m	£m
Capital expenditure 2015/16	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%**
Capital expenditure 2014/15	85.7	17.0	102.7
of which - borrowing	30.8	0.0	30.8
of which – other sources	54.9	17.0	71.9
Borrowing percentage	**36%**	**0%**	**30%**

10.2 Table 8 shows a 9% reduction in the proportion of the general fund capital programme funded from borrowing in 2015/16 as compared to 2014/15. Other sources of capital funding have been applied where available before using unsupported borrowing as funding.

11 Authorised limit and operational boundary for external debt

11.1 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.

11.2 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

11.3 In line with paragraph 11.2 above, in February 2015 as part of the 2015/16 strategy report the Councils operational boundary and authorised limit for 2015/16 were set at £668,000,000 and £738,000,000 respectively. It sets the maximum level of external borrowing on a gross basis (i.e. not net of investments) for the Council. The authorised limit was set on the estimate of the most likely, prudent but not worst case scenario with sufficient headroom over and above this to allow for unusual cash movements. The Councils actual external borrowing plus transferred debt at the end of the year was £465,000,000. This is within the operational boundary and within the authorised limit and indicates that the Council did not breach any of the borrowing limits.

12. Interest rate exposure indicator

12.1 The other locally-set prudential indicator relates to interest rate exposure which allows the Council to manage the extent to which it is exposed to changes in interest rates. It shows the split of borrowing and investments between fixed and variable rates, and the maturity profile of long term loans. Fixed investments and borrowings are those where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate.

The split in respect of borrowing and investments as at 31 March 2016, and the comparative figures for the previous year, are shown in Table 9 below:

Table 9 – Interest Rate Exposure

	2014/15	2015/16
	%	%
Upper Limit on fixed interest rate Exposure	100	100
Actual	89.07	84.27
Upper Limit on variable interest rate exposure	20	20
Actual	10.93	15.73

12.2 These figures show that the Council has not exceeded any limits for the fixed and variable rate borrowing.

12.3 Future borrowing in 2016/17 will be a combination of borrowing from local authorities and PWLB and borrowing from other institutions as agreed in the treasury management strategy. Borrowing from the PWLB will be at a reduction of 20 basis points (bps) on the Standard rate due to the adoption of the Certainty Rate introduced by the PWLB in November 2012 which the Council applied for and has exercised its right to continue to do so in 2016/17.

12.4 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, giving 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.

13. **Loan Maturity Limits**

13.1 One of the treasury management indicators relates to the current loan maturity limit profile, approved by Cabinet in February 2015, which is then compared with the actual structure of borrowing as at 31 March 2016. Table 10 below shows that this indicator has been met as follows:

Table 10 – Maturity Structure of Borrowing

Number of Years to Maturity	Borrowing Profile Set per the 2015/16 Strategy %	Actual Profile of Borrowing at 31 March 2016 %
Up to 1 year	15	0
Up to 2 years	20	0
Up to 5 years	25	6.35
Up to 10 years	50	13.23
Up to 20 years	70	29.26
Up to 30 years	80	34.97
Up to 40 years	90	73.94
Up to 50 years	100	100
50 years and above	0	0

13.2 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 were in accordance with this criteria and no investment made was greater than 365 days.

OTHER OPTIONS CONSIDERED

14.1 None Considered

This report has been approved by the following officers:

Legal officer	Olu Idowu Head of Legal Services
Financial officer	Toni Nash Head of Finance
Human Resources officer	Not Applicable
Estates/Property officer	Not Applicable
Service Director(s)	Martyn Marples, Director of Finance & Procurement
Other(s)	Not Applicable

For more information contact:	Nicola Goodacre Group Accountant Capital & Treasury Management 01332 643352 e-mail nicola.goodacre@derby.gov.uk
Background papers:	None
List of appendices:	Appendix 1

Appendix 1

IMPLICATIONS

Financial and Value for Money

1.1 As described in the report.

Legal

2.1 None directly arising.

Personnel

3.1 None directly arising.

IT

4.1 None directly arising.

Equalities Impact

5.1 None directly arising.

Health and Safety

6.1 None directly arising.

Environmental Sustainability

7.1 None directly arising.

Property and Asset Management

8.1 None directly arising.

Risk Management

9.1 As detailed in the report at paragraphs 5.1, 6.3, and 9.2.

Corporate objectives and priorities for change

10.1 None directly arising.