

Cabinet

13 July 2016

Treasury Management Outturn 2015/16



Report of Corporate Management Team

Paul Darby, Interim Corporate Director Resources

Councillor Alan Napier, Cabinet Portfolio Holder for Finance

Purpose of the Report

- 1 To provide information on the Treasury Management outturn position for the year ended 31 March 2016.

Background

- 2 Treasury Management is the management of the Council's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities, and the pursuit of optimum performance consistent with those risks. It is concerned with how the Council manages its cash resources and its scope covers borrowing, investment and hedging instruments and techniques.
- 3 The regulatory framework governing Treasury Management covers the Council's cash management, loans and investments activity and requires that the Council receive, comment upon and agree regular Treasury Management review reports.
- 4 Risk is inherent in all treasury management activities and it is necessary to balance risk against return on investment.
- 5 As well as meeting the regulatory framework, this report also incorporates the needs of the 'Prudential Code', which can be regarded as being best operational practice, to ensure adequate monitoring of the Council's capital expenditure plans and prudential indicators (PIs). The Treasury Management Strategy and PIs for 2015/16 were agreed by the Council as part of the Medium Term Financial Plan 2015/16 – 2017/18 (MTFP5) on 25 February 2015 and have been updated since as part of the Medium Term Financial Plan 2016/17 to 2019/20 report (MTFP6) that was agreed by the Council on 24 February 2016.
- 6 The report also supports the objective in the revised Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management and the Communities and Local Government Investment Guidance. These state that Members should receive reports and scrutinise the Treasury Management service as part of good governance and best practice.

- 7 During 2015/16 the minimum reporting requirements were that the full Council should receive the following reports:
- an annual Treasury Management Strategy in advance of the year (reported to the County Council on 25 February 2015);
 - a mid-year Treasury Management update report (reported to the County Council on 9 December 2015);
 - an annual review following the end of the year describing the activity compared to the strategy (this report).

External Influences 2015/16

- 8 The following paragraphs contain a commentary from the Council's Treasury Management advisers, Capita Asset Services, who have provided their views on how changes to market expectations influenced the economy during 2015/16.
- 9 Market expectations for the first increase in bank rate since March 2009 moved considerably during 2015/16, starting in quarter 3 of 2015 but soon moving back to quarter 1 of 2016. By the end of the year however, market expectations had moved back radically to quarter 2 of 2018 due to many fears, including concerns that China's economic growth could be heading towards a hard landing; the potential destabilisation of some emerging market countries particularly exposed to the Chinese economic slowdown; and the continuation of the collapse in oil prices during 2015 together with continuing Eurozone growth uncertainties.
- 10 These concerns have caused sharp market volatility in equity prices during the year with corresponding impacts on bond prices and bond yields due to safe haven flows. Bank rate, therefore remained unchanged at 0.5% for the seventh successive year. Economic growth (GDP) in 2015/16 has been disappointing with growth falling steadily from an annual rate of 2.9% in quarter 1 of 2015 to 2.1% in quarter 4.
- 11 The sharp volatility in equity markets during the year was reflected in sharp volatility in bond yields. However, the overall dominant trend in bond yields since July 2015 has been for yields to fall to historically low levels as forecasts for inflation have repeatedly been revised downwards and expectations of increases in central rates have been pushed back. In addition, a notable trend in the year was that several central banks introduced negative interest rates as a measure to stimulate the creation of credit and hence economic growth.
- 12 The European Central Bank (ECB) commenced a full blown quantitative easing programme of purchases of Eurozone government and other bonds starting in March at €60bn per month. This put downward pressure on Eurozone bond yields. There was a further increase in this programme of quantitative easing (QE) in December 2015.

- 13 In America the economy has continued to grow healthily on the back of resilient consumer demand. The first increase in the central rate occurred in December 2015 since then there has been a return to caution as to the speed of further increases due to the concerns around the risks to world growth.
- 14 The UK elected a majority Conservative Government in May 2015, removing one potential concern but introducing another due to the promise of a referendum on the UK remaining part of the European Union (EU). The government maintained its tight fiscal policy stance but the more recent downturn in expectations for economic growth has made it more difficult to return the public sector net borrowing to a balanced annual position within the period of this parliament.

Treasury Position for the Council

- 15 The Treasury position for the Council during 2015/16 is shown in the table below:

	31-Mar-15	Rate/ Return	Average Life	31-Mar-16	Rate/ Return	Average Life
	£million	%	years	£million	%	years
Total Debt	457	4.45		246	4.15	
Capital Financing Requirement (CFR)	636			410		
(-) Under Borrowing	-179			-164		
Total Investments	238	0.71	0.35	195	0.87	0.41
Net Debt (total debt less total investments)	219			51		

- 16 Total debt has fallen by £211million in 2015/16 as a result of debt contributable to the HRA being repaid as part of the housing stock transfer.
- 17 Due to the overall financial position of the Council no new borrowing was raised during 2015/16.

Capital Expenditure and Financing

- 18 The Council undertakes capital expenditure on long-term assets. These activities may either be:
- financed immediately through the application of capital or revenue resources (capital receipts, capital grants or revenue contributions), which has no resultant impact on the Council's borrowing need, or
 - if insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

- 19 Actual capital expenditure forms one of the required prudential indicators. The following table shows actual capital expenditure in 2015/16 and how this was financed.

	2014/15 Actual	2015/16 Budget	2015/16 Actual
	£million	£million	£million
Non-HRA Capital Expenditure	117.214	131.736	115.421
Non-HRA PFI and Finance Lease	2.172	7.193	5.298
HRA Capital Expenditure	42.826	-	-
Total capital expenditure	162.212	138.929	120.719
Resourced by:			
Capital receipts	12.976	16.631	10.183
Capital grants	75.390	52.318	52.172
Capital reserves and revenue	29.049	13.167	23.770
Unfinanced capital expenditure	44.797	56.813	34.594

Overall Borrowing Requirement

- 20 The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).
- 21 The CFR results from the capital activity of the Council and what resources have been used to pay for the capital spend. It represents the 2015/16 unfinanced capital expenditure (see above table), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.
- 22 Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the Corporate Director Resources' treasury management team organises the Council's cash position to ensure sufficient cash is available to meet the capital plans and cash flow requirements.
- 23 This may be sourced through borrowing from external bodies (such as the Government, PWLB or money markets), or internal resources (e.g. use of reserves, working capital).
- 24 The Council's non HRA capital finance requirement (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision (MRP), to reduce the CFR. This is effectively a repayment of the non-HRA borrowing need.
- 25 The Council's 2015/16 MRP Policy, as required by the Department of Communities and Local Government (CLG) guidance was approved as part of the Treasury Management Strategy Report for 2015/16 on 25 February 2015 and updated on 24 February 2016.

- 26 The Council's CFR for 2015/16, as agreed in February 2016, is shown in the following table, and represents one of the key prudential indicators.

CFR	31-Mar-15 Actual	31-Mar-16 Estimate	31-Mar-16 Actual
	£million	£million	£million
Opening balance	607.260	636.459	636.459
Add unfinanced capital expenditure (as above)	44.797	56.813	34.594
Less MRP/ VRP	-15.730	-17.178	-16.569
Adjusted for:			
HRA non-dwelling impairment/ revaluation losses	0.132	-	-
Housing Stock Transfer	-	-244.000	-244.000
Closing balance	636.459	432.094	410.484

- 27 The Housing Stock Transfer did not take place until 13 April 2015 although it had been anticipated to take place in March 2015. Consequently it was not reflected in the calculation of the actual 2014/15 CFR.
- 28 The borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit. In order to ensure that borrowing levels are prudent over the medium term the Council's external borrowing, net of investments, must only be for a capital purpose. This essentially means that the Council is not borrowing to support revenue expenditure.
- 29 The authorised limit is the "affordable borrowing limit" required by section 3 of the Local Government Act 2003. The Council does not have the power to borrow above this level.
- 30 The operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary is acceptable subject to the authorised limit not being breached.
- 31 The table below demonstrates that during 2015/16 the Council has maintained gross borrowing within its authorised limit.

	2015/16 (original) £million	2015/16 (revised) £million
Authorised limit	561.000	561.000
Operational boundary	508.000	508.000
Maximum gross borrowing position		457.375
Average actual gross borrowing position		255.300

Investment Strategy

- 32 The prime objective of the Council's Investment Strategy is to ensure prudent investment of surplus funds. The Council's investment priorities are therefore the security of capital, liquidity of investments and, within those objectives, to secure optimum performance in terms of interest earned. The Council has regard to the CLG Guidance and the CIPFA Treasury Management Code when making its investment decisions.
- 33 Therefore the primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration.

Investment Counterparty Selection Criteria

- 34 The criteria used for providing a pool of high quality investment counterparties with which the Council can invest its surplus funds are:

- Banks 1 – the Council will only use UK banks that have, as a minimum, the following Fitch, Moody's and Standard and Poor's credit ratings (where rated):

	Fitch	Moody's	Standard & Poor's
Short Term	F1	P1	A-1
Long Term	A-	A3	A-

- Non UK Banks 1 – the Council will only use non UK banks which have, as a minimum, the following Fitch, Moody's and Standard and Poor's credit ratings:

	Fitch	Moody's	Standard & Poor's
Sovereign Rating	AA-	AA-	AA-
Short Term	F1	P1	A-1
Long Term	A-	A3	A-

(n.b. viability, financial strength and support ratings have been removed and will not be considered in choosing counterparties.)

- Banks 2 – Part nationalised UK banks – Lloyds Banking Group and Royal Bank of Scotland. These banks can be included if they continue to be part nationalised or they meet the ratings in Banks 1 above.
- Banks 3 – The Council's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time.
- Bank subsidiary and treasury operation - The Council will use these where the parent bank has provided an appropriate guarantee or has the necessary ratings outlined above.

- Building societies - the Council will use societies which meet the ratings for banks outlined above.
- Money market funds.
- Enhanced money market funds.
- UK Government (including gilts and the Debt Management Account Deposit Facility).
- Other local authorities and parish councils.

Time and Monetary Limits Applying to Investments

35 The time and monetary limits for institutions on the Council's counterparty list are as follows (these will cover both specified and non-specified investments):

	Long Term Rating	Monetary Limit	Time Limit
Banks 1 higher quality	AA-	£50million	2 years
Banks 1 medium quality	A	£35million	1 year
Banks 1 lower quality	A-	£25million	6 months
Banks 2 category – part-nationalised	n/a	£60million	2 years
Banks 3 category – Council's banker	A-	£25million	3 months
DMADF/ Treasury Bills	AAA	Unlimited	6 months
Local Authorities	n/a	£10million each	5 years
Money Market Funds	AAA	£20million each (overall £100million)	liquid

Investment Outturn for 2015/16

36 The County Council's surplus cash holding as at 31 March 2016 was £195.444 million which was held in the institutions listed in the following table, alongside their credit rating at that date:

Financial Institution	Short Term Rating	Amount Invested £million
Bank Deposit Accounts		
Handelsbanken	F1+	0.709
Santander UK plc	F1	1.075
Barclays	F1	13.722
Fixed Term Deposits		
Barclays	F1	18.296
Bank of Scotland	F1	54.887
Nationwide Building Society	F1	22.870
Goldman Sachs	F1	32.017
National Westminster	F2	18.296
Local Authorities	N/A	10.200
National Savings and Investments	N/A	0.915
Money Market Funds	N/A	22.458
TOTAL		195.444

37 The investments listed above were held in the following sectors on 31 March 2016 for the time periods shown below:

Sector	Country	0-3 months	6-12 months	Total
Banks	UK	£15million	£123million	£138million
Banks	Non-UK	£1million	0	£1million
Building Societies	UK	-	£23million	£23million
Central Government/ Other Local Authorities	UK	£11million	-	£11million
Money Market Funds	UK	£22million	-	£22million
TOTAL		£49million	£146million	£195million
		25%	75%	

38 The following table provides information on the net interest earned during 2015/16 in comparison to the original budget, the average daily investment balance, and the average return in comparison to the average bank base rate and average 7 day London Interbank Bid (LIBID) rate:

	2015/16
Original budgeted net interest	£1.641million
Actual Net Interest Earned	£1.773million
Average Return Earned	0.68%
Average 7 Day LIBID Rate	0.36%
Average Bank of England Base Rate	0.50%

Icelandic Deposits Update

- 39 Prior to Local Government Review, one former District Council had £7m deposited across the Icelandic banks Glitnir Bank hf (£4m), Landsbanki (£2m) and Kaupthing Singer and Friedlander Ltd (£1m), which all collapsed financially in October 2008. The County Council inherited this position in April 2009.
- 40 The only outstanding balance as at 31 March 2016 is in relation to the investment with Kaupthing Singer and Friedlander Ltd (KSF). All monies with KSF are currently subject to the respective administration and receivership processes. As at 31 March 2016 82.5% of the outstanding balance has been repaid to the Council; 85.75% recovery is ultimately anticipated.

Recommendations and Reasons

- 41 It is recommended that Cabinet note the Treasury Management outturn position for 2015/16 and agree to report this to Full Council on 21 September 2016.

Background Papers

- a) 15 July 2016 – Cabinet - 2015/16 Final Outturn for General Fund, Housing Revenue Account and Collection Fund
- b) 25 February 2015 – County Council - General Fund Medium Term Financial Plan, 2015/16 to 2017/18 and Revenue and Capital Budget 2015/16
- c) 09 December 2016 – County Council - Mid-Year Report for the Period to 30 September 2015 on Treasury Management Service
- d) 24 February 2016 – County Council - Medium Term Financial Plan, 2016/17 – 2018/19 and Revenue and Capital Budget 2016/17

Appendix 1: Implications

Finance

The report details the Council's cash management, loans and investment activity in 2015/16. The report also provides the overall financing of the Council's capital expenditure, along with borrowing and investment income returns.

Staffing

None.

Risk

None.

Equality and Diversity / Public Sector Equality Duty

None.

Accommodation

None.

Crime and Disorder

None.

Human Rights

None.

Consultation

None.

Procurement

None.

Disability Issues

None.

Legal Implications

None.