ASSEMBLY

2 December 2015

Title: Treasury Management Strategy Statement Mid-Year Review 2015/16	
Report of the Cabinet Member for Finance	
Open Report	**For Decision**
Wards Affected: None	**Key Decision: Yes**
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Accountable Director: Jonathan Bunt, Strategic Director, Finance & Investment	

Summary:

Regulation changes have placed greater onus on elected Members in respect of the review and scrutiny of treasury management policy and activities. This mid-year review report is important in that respect as it provides details of the mid-year position for treasury activities and highlights compliance with the Council's policies previously approved by the Assembly.

The Assembly agreed the Treasury Management Strategy Statement for 2015/16 on 24 February 2015 which incorporated the Prudential Indicators.

This report, which was considered and endorsed by the Cabinet at its meeting on 10 November 2015, updates Members on treasury management activities in the current year.

Recommendation(s)

The Assembly is recommended to:

(i) Note the Treasury Management Strategy Statement Mid-Year Review 2015/16;

(ii) Note that in the first half of the 2015/16 financial year that the Council complied with all 2015/16 treasury management indicators;

(iii) Agree to maintain the delegated authority given to the Strategic Director of Finance and Investment, in consultation with the Cabinet Member for Finance, for the duration of the 2015/16 financial year to proportionally amend the counterparty lending limits agreed within the Treasury Management Strategy Statement to take into account the additional £89m from the European Investment Bank; and

(iv) Authorise the Strategic Director of Finance and Investment to make the necessary adjustments to the Treasury Management Strategy to reflect the borrowing of funds and the Capital Financing Requirement to accommodate the additional borrowing arising from the Cabinet's decision under Minute 67, 10 November 2015 to finance the Low Energy Street Light Replacement Programme via the UK Green Investment

Bank's Green Loan.

Reason(s)

This report is required to be presented in accordance with the Revised CIPFA Code of Practice for Treasury Management in the Public Services.

1. Background and Introduction

1.1 The Council operates a balanced budget whereby cash raised during the year meets the Council's cash expenditure needs. Part of the treasury management operations is to ensure this cash flow is adequately planned, with surplus monies invested with counterparties of an appropriate level of risk, providing adequate liquidity before considering maximising investment return.

1.2 The second main function of treasury management is the funding of the Council's capital programme. These capital plans provide a guide to the Council's borrowing need, which is essentially the use of longer term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging loans, using cash flow surpluses or restructuring previously drawn debt to meet Council risk or cost objectives.

1.3 The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2011) the:

I. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management.
II. Creation and maintenance of Treasury Management Practices which set out the how the Council will seek to achieve those policies and objectives.
III. Receipt by the full council of an annual Treasury Management Strategy Statement, including the Annual Investment Strategy and Minimum Revenue Provision Policy for the year ahead, a Mid-year Review Report and an Annual Report (stewardship report) covering activities during the previous year.
IV. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
V. Delegation by the Council to a specific named body, for this Council this is Cabinet, to scrutinise the treasury management strategy and policies.

1.4 This mid-year report has been prepared in compliance with CIPFA's Code of practice on Treasury Management, and covers the following:

1. Economic Summary;
2. Treasury Position at 30 September 2015;
3. Debt Position as at 30 September 2015;
4. Investment Portfolio 2015/16; and
5. The Council's Capital Position (Prudential Indicators), including:
    - Prudential Indicator for Capital Expenditure
    - Changes to the Financing of the Capital Programme
    - Prudential Indicator – Capital Financing Requirement
    - Limits to Borrowing Activity.

2. Economic Update and Interest Rate Forecast

2.1 UK growth continued in 2015, although it did slow marginally with the second quarter of 2015 growth of 2.4% year on year. Growth is expected to weaken marginally to about +0.5% in the third quarter as the economy faces headwinds for exporters from the appreciation of Sterling against the Euro and weak growth in the EU, China and emerging markets, plus the dampening effect of the Government's continuing austerity programme.

2.2 Despite these headwinds, the Bank of England is forecasting growth to remain around 2.4 – 2.8% over the next three years, driven mainly by strong consumer demand as the squeeze on the disposable incomes of consumers has been reversed by a recovery in wage inflation at the same time that CPI inflation has fallen to, or near to, zero over the last quarter. Investment expenditure is also expected to support growth.

2.3 The August Bank of England Inflation Report forecast was notably subdued with inflation barely getting back up to the 2% target within the 2-3 year time horizon. However, with the price of oil taking a fresh downward direction and Iran expected to soon rejoin the world oil market after the impending lifting of sanctions, there could be several more months of low inflation still to come, especially as world commodity prices have generally been depressed by the Chinese economic downturn.

2.4 The impact of the slowdown in growth in the UK and generally within the global economies has pushed back the date for the first rate increases both in the UK and in the US. Despite this, markets have generally provided better returns than over the past two years.

2.5 The steady rather than spectacular growth has pushed back projections for the first rate increase by the Bank of England to 2016, with some economists forecasting a first rate increase in 2017.

2.6 The Council's treasury advisor, Capita Asset Services provides a forecast of rate increases, which was reviewed and amended on 11 August 2015. This latest forecast is outlined in table 1 below includes a first increase in Bank Rate in quarter 2 of 2016. The table forecasts that low rates will remain for the next three years.

Table 1: Interest Rate and PWLB forecasts

	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18
Bank rate	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.50%	1.50%	1.75%	1.75%
5yr PWLB rate	2.40%	2.50%	2.60%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%
10yr PWLB rate	3.00%	3.20%	3.30%	3.40%	3.50%	3.70%	3.80%	3.90%	4.00%	4.10%	4.20%
25yr PWLB rate	3.60%	3.80%	3.90%	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.60%	4.60%
50yr PWLB rate	3.60%	3.80%	3.90%	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.60%	4.60%

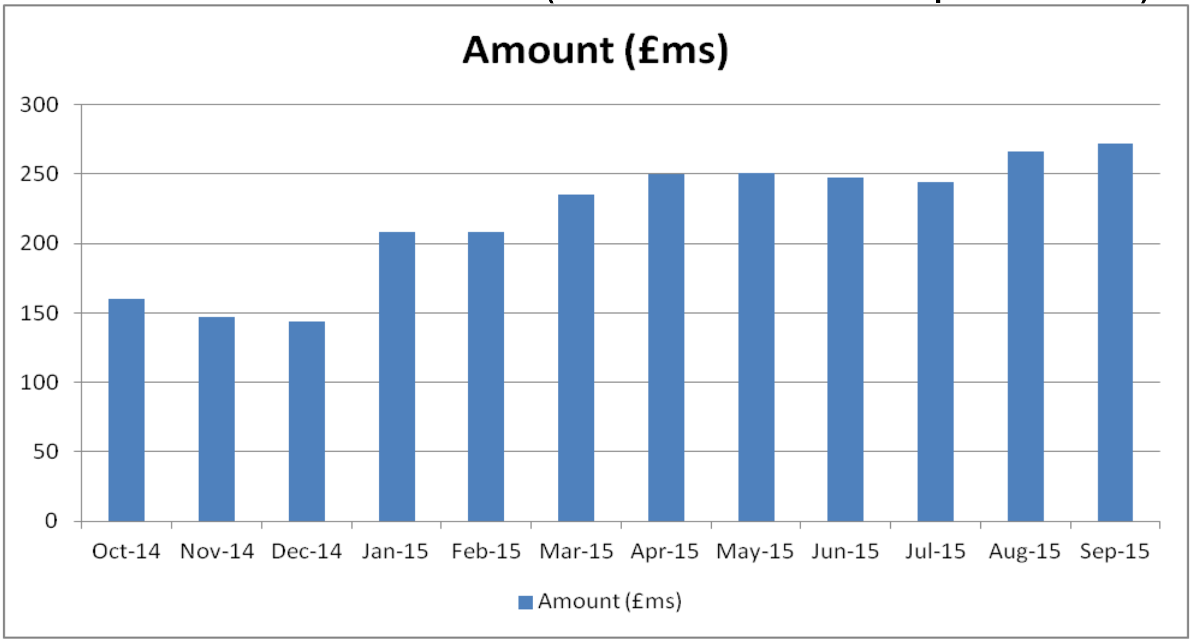
3. Council Cash Position, Treasury Budget and Strategy Amendments

3.1 Council Cash Position

3.1.1 On 30 January 2015 the Council borrowed £89m from the European Investment Bank (EIB) to fund the regeneration of Gascoigne Estate (East) Phase 1 and Abbey Road Phase 2, which resulted in the Council's cash balances increasing significantly. Between February and May 2015 cash positions have continued to increase as a result of back loading and front loading of grants from central government.

3.1.2 There was a further increase in cash held in August as a result of short-term borrowing taken out to manage the Council's cash flow and to enable investments to be made over longer durations. Chart 1 below summarises the investment held by the Council over the past 12 months.

Chart 1: Gross Cash Balances Held (31 October 2014 to 30 September 2015)



3.2 General Fund Treasury Budget Position and Strategy Changes

3.2.1 As part of the Council's savings proposals a number of revisions were made to the General Fund treasury budget for 2015/16, including:

1. **£3.25m** was removed from the interest payment budget; and
2. the General Fund interest receivable budget was increased by **£0.91m**.

3.2.2 As a result of these budget revisions, a total of **£4.16m** was removed from the Treasury interest budget, a reduction from **£4.87m** to a challenging **£0.71m**. To achieve the revised treasury budget, Members approved a number of changes in investment strategy compared to the 2014/15 TMSS, including:

1. Increase the one year Lloyds limit from £50m to £80m.
2. Increase the RBS limit for deals from £35m to £50m.
3. Increase the total Local Authority Limit over one year from £40m to £50m.
4. The minimum credit rating criteria be revised from A / F1 to A- / F2.

5. Maintain the authority delegated to the Strategic Director, Finance & Investment (SDFI), in consultation with the Cabinet Member for Finance, to proportionally amend the counterparty lending limits agreed within the TMSS to take into account the initial increase in cash from the EIB but also the subsequent decrease in cash balances as payments are made to the SPV.

3.3 **Review of exposure to part government owned banks**

3.3.1 The Council's investment strategy included a view that the UK Government would seek to reduce its exposure to Lloyds during 2015/16. The strategy set a minimum Government ownership of Lloyds at 10%, below which the Council's exposure to Lloyds would be reduced to its credit rating limit of £30m. In June 2015 the UK Government announced the proposed sale of its remaining shares in Lloyds and RBS. This led to a review of the Council's exposure to both banks.

3.3.2 **Lloyds:** Following the review, the SDFI, under delegated authority, amended the treasury strategy to reduce the Council's exposure to Lloyds Banking Group from £80m to £60m. The decrease will be managed by not reinvesting the Council's current investments as they mature. It is likely that the Council's exposure to Lloyds Banking Group will decrease further to £30m by the end of the financial year.

3.3.3 **RBS:** RBS is majority owned by the UK Government and it is likely that the significant holding by the Government will remain for at least the next year. As a result, and to accommodate the increased cash balances, the RBS counterparty limit was increased from £50m to £90m for an investment duration of a maximum two years. This limit will be reviewed as each investment with RBS matures and if there are any material changes to the RBS credit rating or Government ownership.

3.4 **Treasury Position at 30 September 2015**

3.4.1 Table 2 details the Council's mid year treasury position. Overall the Council's borrowing has increased from 31 March 2015 due to short-term borrowing. As a result the average cost of borrowing has decreased. Investment balances remain elevated but the return has improved.

Table 2: Council's treasury position at 30 September 2015

	Principal Outstanding £000s	Rate of Return %	Average Life (yrs)
Fixed Rate Borrowing:			
PWLB	(265,912)	3.50	39.89
Market and Local Authority Loans	(183,810)	2.05	25.35
Total Debt	**(449,722)**	**2.90**	**33.94**
Investments			
Banks	204,504	1.23	0.90
Local Authorities	43,500	1.06	1.01
Other Investments	24,374	1.97	1.28
Total Investments	**272,378**	**1.27**	**0.95**

3.5 **Treasury Budget Position**

3.5.1 Although yields have remained at historically low levels for much of the first half of the financial year, a number of opportunistic investments have resulted in a much improved rate of return of **1.27%**. Short-Term borrowing has reduced the overall borrowing costs but the short-term borrowing is intended to manage the current cash flow requirements and, therefore, is reported separately from the longer term borrowing.

3.5.2 Improved investment returns, higher than forecast cash balances, careful management of the Council's cash flow and its borrowing requirement has resulted in a forecast surplus of **£731k** in net interest against budget. This equates to a positive net position for the General Fund borrowing costs of **£19k** (i.e. the Council's General Fund is forecast to receive more in interest income that it will spend on borrowing costs). Table 3 summarises the 2014/15 and 2015/16 budget, the forecast net and the variance between the 2015/16 budget and forecast.

Table 3: 2015/16 Treasury Interest Budget Position

Description	2014/15 Budget	2015/16 Budget	2015/16 Forecast	Variance
	£000's	£000's	£000's	£000's
Interest Payable (Excluding HRA)	(5,501)	(2,251)	(1,611)	640
Short-Term Borrowing			(86)	(86)
Total Borrowing Costs	(5,501)	(2,251)	(1,697)	554
Net Interest to the General Fund	629	1,539	1,716	177
Net Interest Payable to GF	**(4,872)**	**(712)**	**19**	**731**

3.6 **European Investment Bank Loan**

3.6.1 In August 2014, Cabinet agreed to the regeneration of the Gascoigne Estate and Abbey Road and that financing of £89m would be provided by a loan from the European Investment Bank (EIB). This decision was ratified by the Assembly in September 2014. Cabinet also agreed that, given the low borrowing costs at the time, £2m from the Budget Support Reserve (BSR) would be made available to pay for interest costs in the development period. On 30 January 2015 £89m was borrowed from the EIB at a competitive rate of 2.21% for a duration of 30 years.

3.6.2 Costs of £120k were charged to the BSR for costs incurred in 2014/15. Table 4 below provides a summary of the likely costs that will be charged to the BSR in 2015/16 and 2016/17 as a result of borrowing the full £89m in advance. It is expected that sufficient income will be received from Gascoigne Estate and Abbey Road 2 to cover the interest and capital repayments in 2018/19.

Table 4: 2015/16 and 2016/17 EIB Borrowing Costs

	2015/16	2016/17
Gross Interest (EIB)	1,964,230	1,964,230
Interest Income from Abbey Road 2	(460,668)	(587,864)
Interest from Cash Balance	(840,000)	(650,000)
Total Charge	663,562	726,366

4. Debt Position at 30 September 2015

4.1 The Council's capital financing requirement (CFR) for 2015/16 is forecast to be £588,244. The CFR denotes the Council's underlying need to borrow for capital purposes, which is met through the use of reserves, external borrowing, internal borrowing and careful management of the Council's cash flow. The Council holds £40m of Lender Option, Borrower Option (LOBO) loans, with an average fixed rate of 4.0%. Table 5 provides a breakdown of the Council's debt as at 30 September 2015.

Table 5: General Fund Debt held as at 30 September 2015

Borrowing/ Loan Held	Type	Interest Rate	Principal	Start Date	End Date
		%	£000s	£000s	£000s
PWLB	HRA	3.50	50,000	28/03/2012	28/03/2042
PWLB	HRA	3.52	50,000	28/03/2012	28/03/2050
PWLB	HRA	3.49	50,000	28/03/2012	28/03/2060
PWLB	HRA	3.49	50,000	28/03/2012	28/03/2061
PWLB	HRA	3.48	65,912	28/03/2012	28/03/2062
EIB	General Fund	2.21	89,000	30/01/2015	31/03/2044
Barclays (LOBO)	General Fund	3.98	10,000	30/05/2008	30/05/2008
Dexia (LOBO)	General Fund	3.97	10,000	30/06/2008	30/05/2008
RBS (LOBO)	General Fund	4.05	10,000	26/03/2010	30/05/2008
RBS B (LOBO)	General Fund	4.07	10,000	26/03/2010	30/05/2008
Short-term Loan	General Fund	0.36	54,810	Various	Various
Total		**2.90**	**449,722**		

4.2 The Council holds sufficient cash balances to allow a large portion of its overall borrowing requirements to be funded internally. This approach has provided the Council with savings as the cost to borrow is significantly higher than the return achieved by investing the cash. While interest rates remain higher than investment rates, the Council will seek to delay new loans as long as possible. Where borrowing is considered, officers will base any decision on the Council's cash flow requirements and at the most appropriate and cost effective interest rate available.

4.3 Low Energy Street Light Replacement Programme

4.3.1 At its meeting on 24 March 2015, Cabinet approved the commitment of £250,000 to support detailed business planning of an initial renewable energy investment programme and the establishment of an Energy Services Company.

4.3.2 At its meeting on 10 November 2015, the Cabinet approved proposals to procure the replacement of the borough's existing street lights with low energy Light Emitting Diode (LEDs) lanterns and to enter into an agreement with the Green Investment Bank (GIB) to finance the procurement and replacement on an 'invest to save' basis. The proposals set out in the "Low Energy Street Light Replacement Programme" report will deliver immediate and long-term financial savings through lower energy use and will also help to reduce carbon emissions as part of the Council's commitment to tackle climate change.

4.3.3 It was agreed to fund the project using £7.5m of GIB borrowing using the Green Loan model which has been specifically developed to fund local authority LED street light replacement programmes. Although more expensive in overall financing costs, this option generates savings throughout the installation period and the operational period of the project and therefore shows better value for money for the project.

4.3.4 This option generates a net saving in the first five years of an estimated £1.0m compared to a net cost of £0.5m if funded using the PWLB borrowing. In addition the GIB team provides additional assistance by working alongside the project team to support project execution.

4.3.5 In view of the Cabinet's decision, it is necessary to increase the Capital Financing Requirement by £7.5m to accommodate this additional borrowing. The borrowing, with the accrued interest, shall be repaid using the savings that shall be generated.

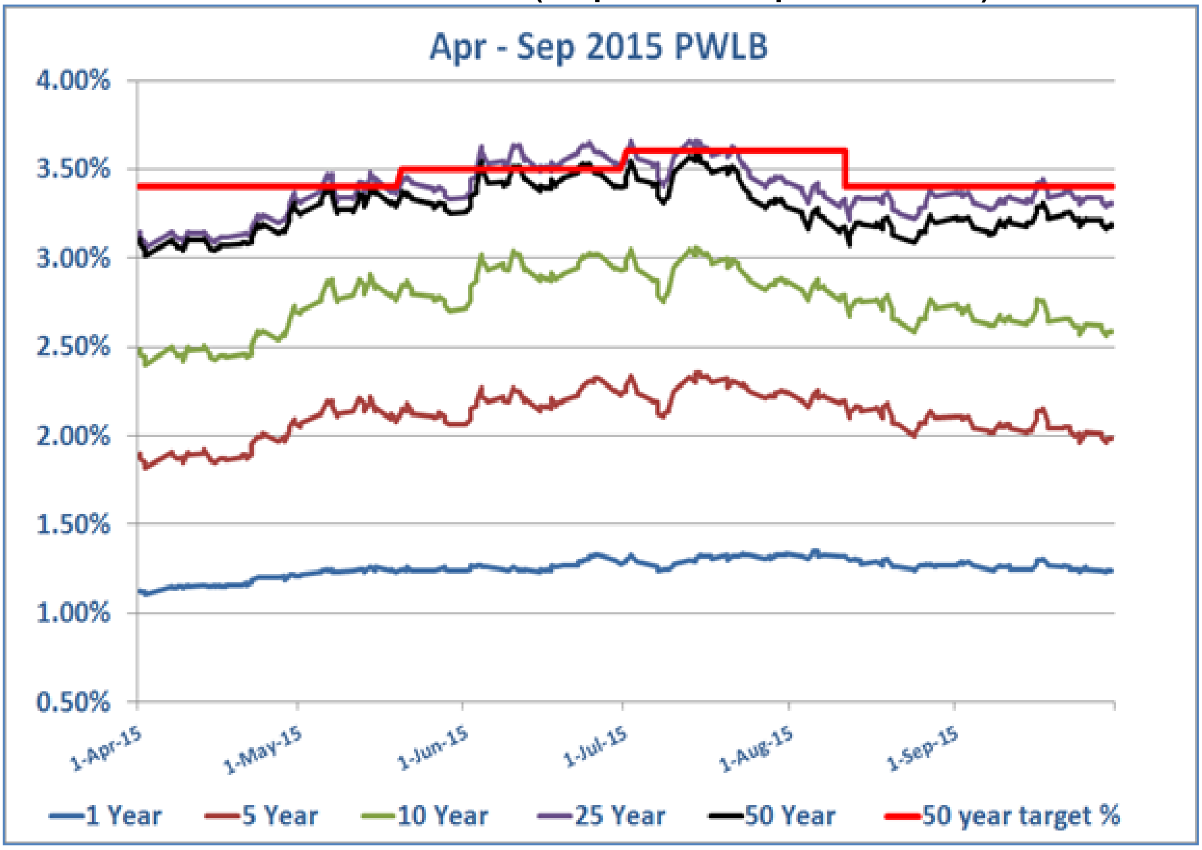
4.4 **Debt Repayment and Rescheduling**

4.4.1 Debt rescheduling opportunities are limited in the current economic climate. No debt rescheduling or repayments were undertaken during the first six months of the financial year.

4.5 **PWLB Rates**

Chart 2 below shows the movements in PWLB rates for the first six months of the financial year (to 30 September 2015).

Chart 2: Movement in PWLB rates (1 April to 30 September 2015)



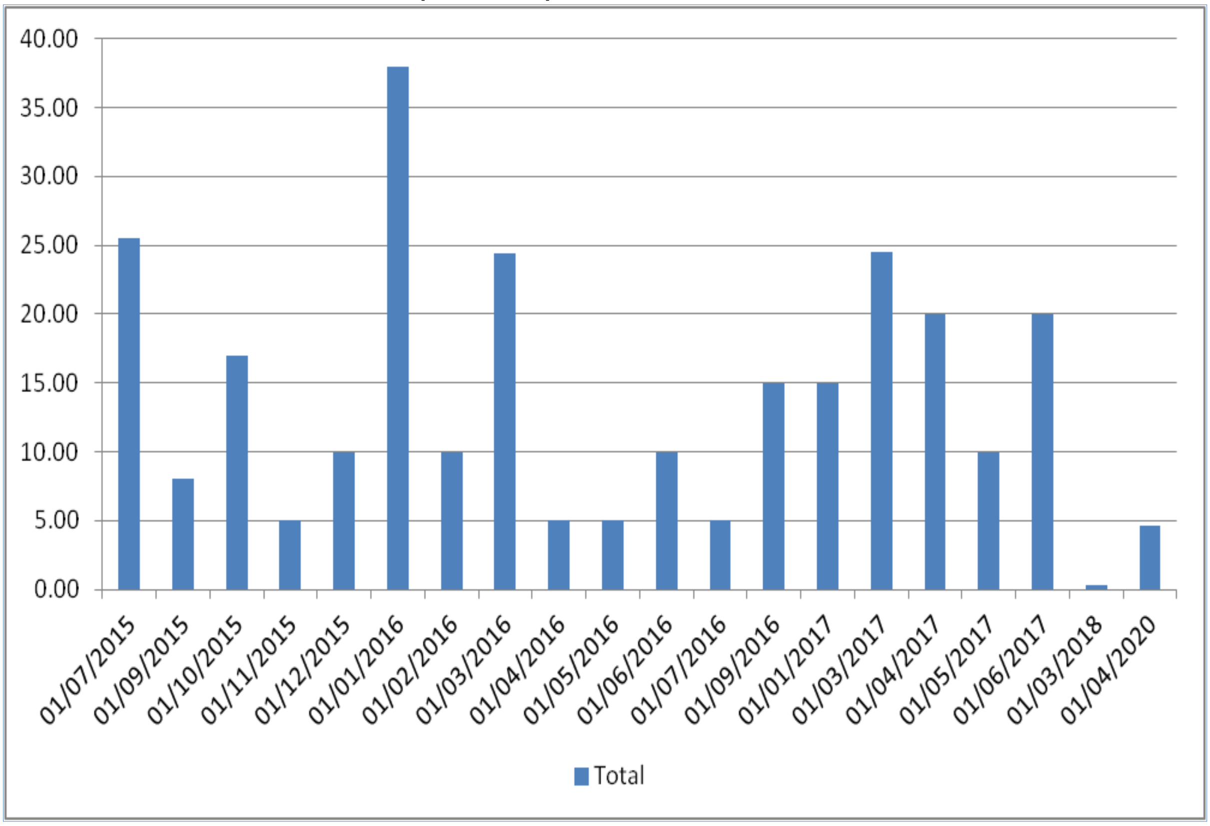
5. Investment Portfolio 2015/16

5.1 It is the Council's priority to ensure security of capital and liquidity before obtaining an appropriate level of return which is consistent with the Council's risk appetite. In the current economic climate the Council's risk appetite remains relatively low. There is an expectation that the base rate, currently at 0.5%, will increase in 2016 if economic indicators improve, which may increase the interest received.

5.2 Investment Profile

5.2.1 The Council's investment maturity profile in Chart 3 below shows that as at 30 September 2015, 12.3% of the Council's investments had a maturity of 60 days or less, with 65.3% having a maturity of one year or less. Spreading out the maturity of longer dated investments allows the Council to take advantage of improved rates of return while ensuring sufficient liquidity.

Chart 3: Investment Profile (Millions)



5.3 Holdings and Return

5.3.1 As at 30 September 2015 the Council held £272.4m of investments, all invested in-house by the Council's treasury section. The SDFI confirms that the approved investment limits within the Annual Investment Strategy were not breached during the first six months of 2015/16. A full list of investments as at 30th September 2015 can be found in appendix 1.

5.3.2 The average return increased over the first six month of the financial year to 1.27% with returns for the remainder of the year likely to average 1.32%. The average return for 2015/16 is forecast to be 1.29%.

6. The Council’s Capital Position (Prudential Indicators)

6.1 Prudential Indicator for Capital Expenditure

6.1.1 Table 6 shows the changes to the original capital expenditure budgets. Table 5 also highlights the original supported and unsupported elements of the capital programme, and the expected financing arrangements of this capital expenditure.

6.1.2 The borrowing need increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced by revenue charges for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

Table 6: Revised Estimate to Capital Programme as at 30 September 2015

Capital Expenditure by Service	2015/16 Original Budget £000s	2015/16 Revised Budget £000s
Adult & Community Services	2,682	2,192
Children’s Services	32,799	27,111
Housing and Environment	4,215	4,005
Chief Executive	12,437	7,489
HRA	77,987	81,493
Reside 2 (Abbey Road / Gascoigne)	0	9,222
Total	**130,120**	**131,511**
Financed by:		
Capital grants & contributions	37,173	31,816
Capital receipts	2,258	2,477
Contributions Revenue / Reserves	2,364	1,477
MRA / HRA funding	74,787	81,493
Total financing	**116,582**	**117,263**
Borrowing need	**13,538**	**14,248**

6.2 Prudential Indicator – CFR

6.2.1 Table 7 shows that the Council is on target to achieve the original forecast CFR. The SDFI reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

6.2.2 The Authorised Limit represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

6.2.3 There is currently a significant difference between the Authorised Limit and the actual borrowing. This difference is made up of internal borrowing, the remaining

£61m which could potentially be borrowed from the EIB and headroom to accommodate any potential new borrowing requirements.

Table 7: Revised Capital Financing Requirement as at 30 September 2015

	2015/16 Original Estimate £000s	**2015/16 Revised Estimate £000s**
Prudential Indicator – Capital Financing Requirement		
CFR – non housing	149,623	153,547
CFR – housing	267,722	270,922
Reside 1 and 2	102,675	108,531
Alternative Financing (PFI and leases)	55,245	55,245
Total CFR	**578,098**	**588,244**
Net movement in CFR	**93,355**	**10,146**
Prudential Indicator – External Debt / the Operational Boundary		
Long Term Borrowing	394,912	394,912
Other long term liabilities	53,750	53,750
Total debt 31 March	**448,692**	**448,692**
Operational Boundary	**751,000**	**751,000**
Authorised Limit	**800,000**	**800,000**

6.3 **Treasury Indicators: Limits to Borrowing Activity**

6.3.1 There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance. The indicators are:

- Upper limits on variable interest rate exposure: identifies a maximum limit for variable interest rates based upon the debt position net of investments;
- Upper limits on fixed interest rate exposure: is similar to the previous indicator and covers a maximum limit on fixed interest rates; and
- Maturity structure of borrowing: gross limits to reduce the Council's exposure to large fixed rate sums requiring refinancing.

6.3.2 The SDFI reports that there were no breaches in any of the limits outlined below:

Interest rate exposures	**2015/16**	**2016/17**	**2017/18**
	Upper	**Upper**	**Upper**
Limits on fixed interest rates based on net debt	100%	100%	100%
Limits on variable interest rates based on net debt	70%	70%	70%
Limits on fixed interest rates:			
• ***Debt only***	100%	100%	100%
• ***Investments only***	80%	80%	80%
Limits on variable interest rates			
• ***Debt only***	70%	70%	70%
• ***Investments only***	80%	80%	80%

Maturity structure of fixed interest rate borrowing 2015/16		
	Lower	**Upper**
Under 12 months	0%	20%
12 months to 2 years	0%	40%
2 years to 5 years	0%	70%
5 years to 10 years	0%	70%
10 years and above	0%	100%

Maturity structure of variable interest rate borrowing 2015/16		
	Lower	**Upper**
Under 12 months	0%	40%
12 months to 2 years	0%	40%
2 years to 5 years	0%	70%
5 years to 10 years	0%	70%
10 years and above	0%	80%

7. Consultation

7.1 The Strategic Director, Finance & Investment, in his role as statutory chief finance officer, has been informed of the approach, data and commentary in this report.

7.2 This report was considered and endorsed by the Cabinet at its meeting on 10 November 2015.

8. Financial Implications

Implications completed by: Jonathan Bunt, Strategic Director, Finance & Investment

8.1 This report sets out the mid-year position on the Council's treasury management position and is concerned with the returns on the Council's investments as well as its short and long term borrowing positions.

9. Legal Implications

Implications completed by: Eldred Taylor-Camara, Legal Group Manager

9.1 The Local Government Act 2003 (the "Act") requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy which sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

9.2 The Council also has to 'have regard to' the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities when carrying out its functions under the Act.

9.3 A report setting out the Council's strategies in accordance with the Act was presented to the Assembly in February 2015. This report is a midyear review of the strategy's application and there are no further legal implications to highlight.

10. Options Appraisal

10.1 There is no legal requirement to prepare a Treasury Management Strategy Statement Mid-year Review; however, it is good governance to do so and meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

11. Other Implications

11.1 **Risk Management** - The whole report concerns itself with the management of risks relating to the Council's cash flow. The report mostly contains information on how the Treasury Management Strategy has been used to maximise income during the first 6 months of the year.

Background Papers Used in the Preparation of the Report:

- Local Government Act 2003
- CIPFA – Revised Prudential Code for Capital Finance in Local Authorities
- CIPFA – Revised Treasury Management in the Public Services
- HRA Business Plan v7 (16 Jan 2012)
- Treasury Management Strategy Statement - Assembly Report 19 February 2015

List of appendices:

- Appendix 1: Investments as at 30 September 2015