

Meeting: Council

Date: 21 July 2016

Wards Affected: All Wards in Torbay

Report Title: Treasury Management Outturn 2015/16

Is the decision a key decision? No

When does the decision need to be implemented? ASAP

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1. Proposal and Introduction

- 1.1 This report informs Members of the performance of the Treasury Management function in supporting the provision of Council services in 2015/16 through management of cash flow, debt and investment operations and the effective control of the associated risks.
- 1.2 The headline points of the report are:
- No opportunities in the year to early repay existing borrowing
 - No new borrowing taken to fund the Capital Investment Plan with capital expenditure of £7.7million funded in-year from internal resources
 - Annual investment rate achieved exceeded the market and peer benchmark levels
 - Treasury Management activities were slightly overspent against the approved budget target

2. Reason for Proposal

- 2.1 The Council is required through regulations issued under the Local Government Act 2003 to produce an annual outturn report reviewing treasury management activities and the actual prudential and treasury indicators for 2015/16.

3.2 This report also meets the requirements of the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

3. Recommendation(s) / Proposed Decision

3.1 That the Treasury Management decisions made during 2015/16, as detailed in the submitted report be noted; and

3.2 That the performance against the approved Prudential and Treasury Indicators as set out in Appendix 1 to the submitted report be noted.

4. Background Information

4.1 Treasury management is defined by the Code of practice as:

“The management of the authority’s investments and cash flows, it’s 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”.

4.2 During 2015/16 the minimum reporting requirements were that full Council should receive the following reports:

- An annual treasury strategy in advance of the year (Council 5th February 2015)
- A mid-year review report (Council 22nd October 2015)
- An annual report following the year describing the activity compared to the strategy (this report)

4.3 The regulatory environment places responsibility on Members for the review and scrutiny of treasury management policy and activities. This report is therefore important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the policies previously approved by Members.

4.4 The Council confirms that it has complied with the requirement under the Code to give prior scrutiny to the above strategy and mid-year treasury management reports by the Audit Committee before they were reported to full Council. In view of tight reporting deadlines and to avoid delay in reporting the Chair of Audit Committee has given approval for this outturn statement to be presented direct to full Council. The nature of the report does not require decision.

4.5 Member training on treasury management issues was undertaken during the year on 15th July 2015 in order to support members’ scrutiny role.

4.6 Treasury Management strategies were planned and implemented in conjunction with the Council’s appointed advisors, Capita Asset Services although the Council officers were the final arbiters of the recommended approach.

4.6 This report covers:

- The Economy and Interest rates
- Treasury Position at year end;
- The Strategy for 2015/16;
- Borrowing Outturn for 2015/16;
- Investment Outturn for 2015/16;
- Revenue Budget Performance;
- Reporting Arrangements and Management Evaluation
- Prudential and Treasury Indicators (Appendix1)

5. The Economy and Interest Rates

5.1 A commentary provided by Capita Asset Services is presented at Appendix 2 to the report.

6. Overall Treasury Position as at 31 March 2016

6.1 At the beginning and the end of 2015/16 the Council's treasury position was as follows:

TABLE 1	31 March 2015 Principal	Rate/ Return	Average Life yrs	31 March 2016 Principal	Rate/ Return	Average Life yrs
Borrowing	£138.1m	4.39%	27.5 years	£138.1m	4.39%	26.5 years
Other long term liabilities	£8.4m	5.26%	12.5 years	£20.2m	5.26%	11.5 years
Total debt	£146.5m	4.44%	26.7 years	£158.3m	4.44%	25.7 years
CFR	£135.3m			£151.1m		
Over borrowing	£11.2m			£7.2m		
Total investments	£69.7m	0.88%		£54.6m	0.91%	
Net debt	£76.8m	3.29%		£103.7m	3.48%	

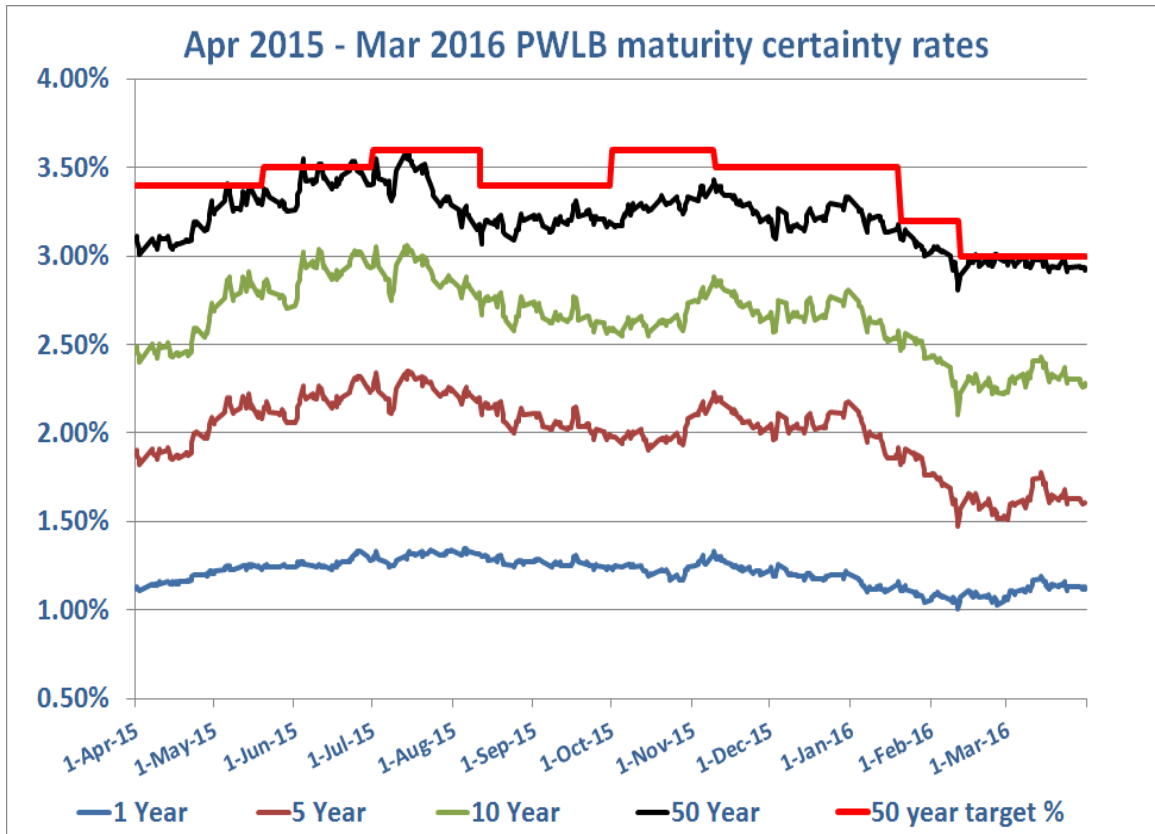
7. The Strategy for 2015/16

7.1 The primary aim of the 2015/16 Strategy was to seek opportunities for the early repayment of borrowing and utilise internal cash resources to fund capital expenditure in the short term

7.2 In view of the forecast for low interest rates an element of core investment balances were to be exposed to deposits of one year or longer duration (subject to rate levels and suitable counterparty availability) to lock into higher yield levels. A proportion of in-house managed funds were to be held in short-term variable rate instruments to enact strategy transactions and to mitigate a rise in investment rates.

8. Borrowing Outturn 2015/16

8.1 The graph below shows how PWLB certainty rates (new loan rates) have fallen to historically very low levels during the year.



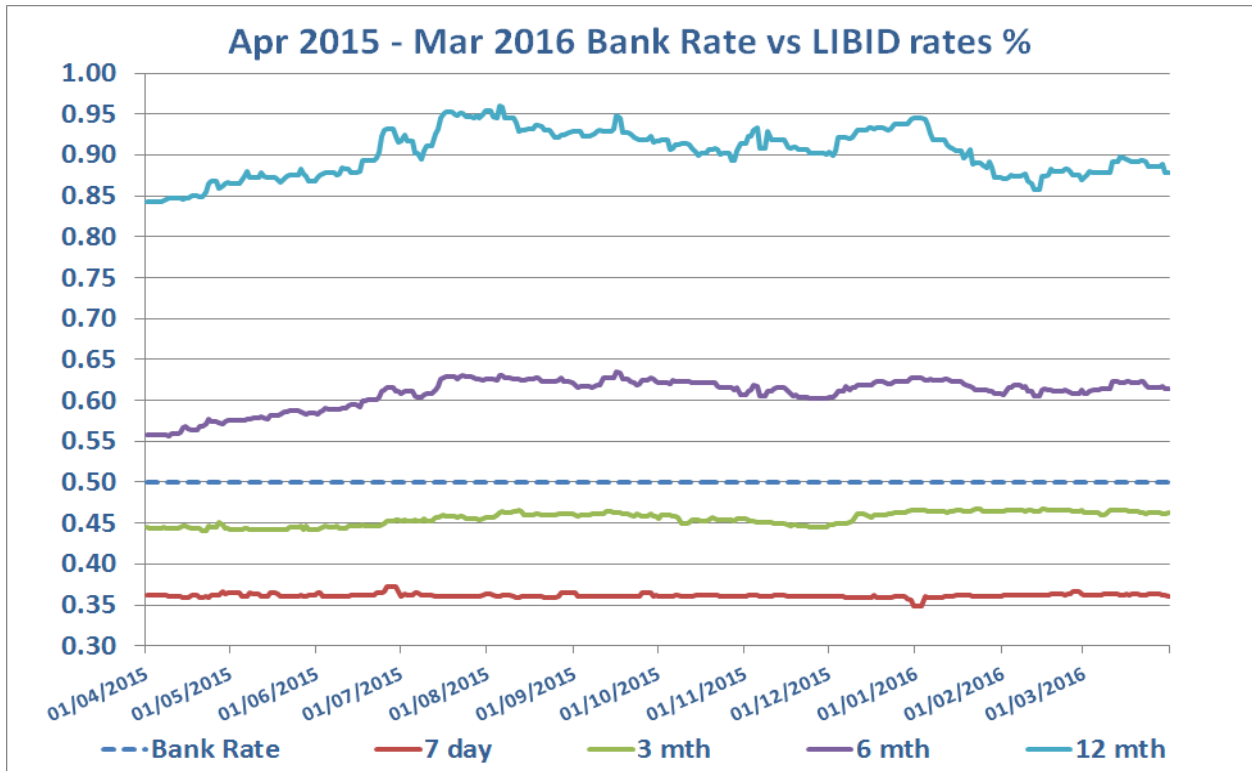
8.2 The rates for early repayment of loans, as relating to the strategy, is a margin lower than these levels and in this climate gave no economic opportunity to repay loans during the year.

8.3 No new borrowing was taken for approved capital schemes with £7.7million of capital expenditure funded in year from internal resources

8.4 The borrowing portfolio (excluding other long term liabilities) remains at £138.1million and the average rate of interest paid on all loans in 2015/16 was 4.39%.

9. Investment Outturn 2015/16

9.1 The movement in key market investment rates during 2015/16 are illustrated in the table below.



9.2 Bank Rate remained at its historic low of 0.5% throughout the year; it has now remained unchanged for seven years. Market expectations as to the timing of the start of monetary tightening started the year at quarter 1 2016 but then moved back to around quarter 2 2018 by the end of the year. Deposit rates remained depressed during the whole of the year, primarily due to the effects of the Funding for Lending Scheme and due to the continuing weak expectations as to when Bank Rate would start rising.

9.3 In line with the approved strategy £7million was deposited with local authorities over three years to lock into higher rates over the longer term. This supplemented existing longer term deals made in expectation of no rise in Bank Rate in the medium term.

9.4 During the year Officers evaluated the potential use of higher risk investments to gain yield in the current restrictive climate. Following recommendations to Council the use of the Funding Circle (peer-to-peer) facility was approved on an experimental basis. The performance of the Funding Circle holding at 31st March 2016 is summarised below:

Total Invested	£130,000
No. of loan parts	283
Gross yield	7.9%
Return net of fees	7.2%
Proportion of secured/unsecured loans (by loan principal)	
- Secured	36%
- Unsecured	64%
Proportion of loans by credit rating (by loan principal)	
- A+	70.3%
- A	20.9%
- B	8.8%

9.5 **Externally Managed Investments** – Aberdeen Asset Management manages a proportion of the Council's to add value by way of market knowledge and exposure to a greater diversity of investments and counterparties. The total holding in the external fund was reduced during the year from £30million to £18million to meet capital expenditure funding requirements.

9.6 **Performance Analysis** - Detailed below is the result of the investment strategy undertaken by the Council. Despite the continuing difficult operating environment the Council's investment returns remain well in excess of the benchmark.

	Average Investment Principal	Rate of Return (gross of fees)	Rate of Return (net of fees)	Capita Benchmarking Club		CIPFA Benchmarking Club (Draft)	Market Benchmark/ Target Return
				Peer LA Comparison	English Unitaries		
Internally Managed	£50million	0.99%		0.77%	0.86%	0.73%	0.36%
Externally Managed	£28million	0.76%	0.61%			2.41%*	0.36%

*Includes property funds

9.7 In interest terms, the in-house treasury function contributed an additional £315,000 to the General Fund over and above what would have been attained from the benchmark return. Aberdeen's net return achieved an additional £70,000 over their target return level of 10% above benchmark.

10 Revenue Budget Performance

10.1 The effect of the decisions outlined in this report on the approved revenue budget is outlined in the table below.

	Revised Budget 2015/16	Actual 2015/16	Variation
	£M	£M	£M
Investment Income	(0.6)	(0.6)	0.0
Interest Paid on Borrowing	6.1	6.1	0.0
Net Position (Interest)	5.5	5.5	0.0
Minimum Revenue Provision (MRP)	4.2	4.2	0.0
MRP re: PFI	0.5	0.7	0.2
PFI Grant re: MRP	(0.5)	(0.5)	0.0
Net Position (Other)	4.2	4.4	0.0
Net Position Overall	9.7	9.9	0.2

10.2 The position was regularly reported to OSB and Council throughout the year as part of the budget monitoring reports to Members

11 Reporting Arrangements and Management Evaluation

13.1 The management and evaluation arrangements identified in the annual strategy and followed for 2015/16 were as follows:

- Monthly monitoring report to Executive Lead for Finance, Chief Finance Officer and Group Leaders
- Regular meeting of the Treasury Manager and Chief Accountant to review previous months performance and plan following months activities
- Regular meetings with the Council's treasury advisors
- Regular meetings with the Council's appointed Fund Manager
- Membership and participation in Capita Treasury Services Investment Benchmarking Club

Appendices

Appendix 1: Prudential and Treasury Indicators 2015/16

Appendix 2: The Economy and Interest Rates

Appendix 3: Counterparties with which funds have been deposited in 2015/16

Background Documents

None

Appendix 1

Prudential and Treasury Indicators 2015/16

Capital Expenditure and Financing 2015/16

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, revenue contributions etc.), 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 (though the timing of borrowing may be delayed through the application of cash balances held by the Council).

The actual capital expenditure forms one of the required prudential indicators and is shown in the table below.

	2014/15 Actual £m	2015/16 Revised Budget £m	2015/16 Actual £m
Total capital expenditure	20	30	35*

* The Actual for 2015/16 recognises £12m of Energy from Waste assets.

Capital Financing Requirement

The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's net debt position. 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 and prior years' net or unfinanced capital expenditure which has not yet been financed by revenue or other resources.

Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the Government, through the Public Works Loan Board [PWL] or the money markets), or utilising temporary cash resources within the Council.

Reducing the CFR – the Council's underlying borrowing need (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 the reserving of funds for repayment of the borrowing need. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. The Council's 2015/16 MRP Policy (as required by CLG Guidance)

was approved as part of the Treasury Management Strategy Report for 2015/16 on 5th February 2015.

The total CFR can also be reduced by:

- the application of additional capital financing resources (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

The Council's CFR for the year represents a key prudential indicator analysed below. This includes PFI schemes on the balance sheet, which increase the Council's long term liabilities. No borrowing is actually required against these schemes as a borrowing facility is included in the contract (if applicable).

CFR (£m)	31 March 2015 Actual	31 March 2016 Revised Indicator	31 March 2016 Actual
CFR at Year End	135.3	138.0	151.1

The borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit presented at Appendix 1 to this report.

Net borrowing and the CFR - 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. Net borrowing should not therefore, except in the short term, have exceeded the CFR for 2015/16 plus the expected changes to the CFR over 2016/17 and 2017/18. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs. The table below highlights the Council's net borrowing position against the CFR. The Council has complied with this prudential indicator.

CFR (£m)	31 March 2015 Actual	31 March 2016 Actual
Opening balance	135.0	135.3
Capital expenditure in year funded from borrowing	4.9	7.7
EFW PFI Liability	0	12.4
Minimum Revenue Provision	(4.6)	(4.3)
CFR at Year End	135.3	151.1
Net borrowing position	76.8	103.7

The authorised limit - the authorised limit is the “affordable borrowing limit” required by s3 of the Local Government Act 2003. The Council does not have the power to borrow above this level. The table below demonstrates that during 2015/16 the Council has maintained gross borrowing within its authorised limit.

The operational boundary – 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. Borrowing levels were maintained well below the operational boundary throughout the year.

Actual financing costs as a proportion of net revenue stream - this indicator identifies the trend in the cost of capital (borrowing and other long term liabilities net of investment income) against the net revenue stream.

	2015/16
Authorised limit*	£207m
Maximum gross borrowing position	£158m
Operational boundary	£188m
Average gross borrowing position	£152m
Financing costs as a proportion of net revenue stream	9.2%

Treasury Indicators:

Maturity Structure of the fixed rate borrowing portfolio - This indicator assists Authorities avoid large concentrations of fixed rate debt that has the same maturity structure and would therefore need to be replaced at the same time.

	31 March 2016 Actual	31 March 2016 Proportion	2015/16 Original Limits Upper- Lower
Up to 10 years	£24M	17%	5% - 50%
10 to 20 years	£21M	16%	5% - 50%
20 to 30 years	£38M	28%	10% - 60%
30 to 40 years	£37M	26%	10% - 50%
Over 40 years	£18M	13%	0% - 50%

Principal sums invested for over 364 days - The purpose of this indicator is to contain the Council's exposure to the possibility of losses that might arise as a result of it having to seek early repayment or redemption of principal sums invested. The figures presented allow for the proportion of the externally managed fund invested over 1 year. In practice this sum can be realised at short notice but is included within this Indicator as there would be a risk of negative impact on the fund yield.

	2014/15 Actual	2015/16 Limit	2015/16 Actual
Investments of 1 year and over	£15M	£51m	£22m

Exposure to Fixed and Variable Rates - The Prudential Code requires the Council to set upper limits on its exposure to the effects of changes on interest rates. The exposure to fixed and variable rates was as follows:

	31 March 2015 Actual %	2015/16 Upper Limits %	31 March 2016 Actual %
Limits on fixed interest rates:			
• Debt only	100	100	100
• Investments only	52	80	52
Limits on variable interest rates			
• Debt only	0	20	0
• Investments only	47	60	47

Appendix 2

The Economy and Interest Rates

By Capita Asset Services April 2016

Market expectations for the first increase in Bank Rate moved considerably during 2015/16, starting at quarter 3 2015 but soon moving back to quarter 1 2016. However, by the end of the year, market expectations had moved back radically to quarter 2 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.

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 2015 to 2.1% in quarter 4.

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.

The 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 QE in December 2015.

As for 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 when there has been a return to caution as to the speed of further increases due to concerns around the risks to world growth.

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 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.

Appendix 3

Counterparties with which funds were deposited (April 2015 – March 2016)

Banks and Building Societies

Bank of Scotland
Barclays Bank
Goldman Sachs International Bank
Lloyds Bank
Nationwide Building Society
Royal Bank of Scotland/National Westminster
Santander UK
Svenska Handelsbanken

Local Authorities

Greater London Authority
Lancashire County Council
Nottinghamshire Police and Crime Commissioner

Other Approved Institutions

Public Sector Deposit Fund
Goldman Sachs Sterling Fund
Aberdeen Asset Management
Funding Circle