

AUDIT COMMITTEE	AGENDA ITEM No. 8
21 NOVEMBER 2016	PUBLIC REPORT

Committee Member(s) responsible:	Resources portfolio holder, Cllr Seaton		
Contact Officer(s):	John Harrison, Corporate Director: Resources	☎ 452398	
	Steven Pilsworth, Service Director: Financial Services	☎ 384569	

TREASURY MANAGEMENT MID YEAR UPDATE

R E C O M M E N D A T I O N S	
FROM : John Harrison, Corporate Director: Resources	Deadline date : N/A
Audit Committee is asked to	
1. To review current performance against the Treasury Management Strategy (TMS) set in the Medium Term Financial Strategy (MTFS)	

1. ORIGIN OF REPORT

- 1.1 The Treasury Management in the Public Services: Code of Practice 2011 recommends that Members receive reports on its treasury management policies, practices and activities, including an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close.
- 1.2 The annual strategy is approved by Council as part of the MTFS. The original strategy was approved on 9 March 2016 however, the MTFS and corresponding TMS were revised, resubmitted and approved on 13 July 2016. The Revised MTFS (and related Prudential Indicators) incorporate changes to the Invest to Save programme. The final performance against the revised strategy will be reported to Audit Committee in June 2017 alongside the Statement of Accounts. This report forms the mid-year review against the Revised TMS.

2. PURPOSE AND REASON FOR REPORT

- 2.1 To report current performance and the forecast outturn position against the Prudential Indicators in the strategy.
- 2.2 This is in accordance with the Committees' Terms of Reference – 2.2.1.15 To consider the Council's arrangements for corporate governance and agreeing necessary actions to ensure compliance with best practice.

3. TIMESCALE

Is this a Major Policy Item / Statutory Plan?	NO	If Yes, date for relevant Cabinet Meeting	N/A
---	-----------	---	-----

4. TREASURY MANAGEMENT STRATEGY PRUDENTIAL INDICATORS

- 4.1 The Prudential Code underpins the system of capital finance. Local authorities determine their own programmes for capital investment in long term and current assets that are central to the delivery of quality local public services. Prudential indicators are developed as part of the annual MTFS process to ensure that:

a) Capital investment plans are affordable;

- b) All external borrowing and other long term liabilities are within prudent and sustainable levels; and
- c) Treasury management decisions are taken in accordance with professional good advice.

- 4.2 The 2016/17 Prudential Indicators are shown in Appendix 1. The Council's performance to date and forecast performance are all within the limits set in the Revised MTFS.
- 4.3 The Council has continued to operate a restrictive lending list due to the continued economic uncertainty. Surplus cash is only invested for short periods with Barclays, Bank of Scotland (part of the Lloyds Banking Group). The Council also invests with other Local Authorities and the Debt Management Office (DMO).
- 4.4 Since the decision to leave the EU, financial institution credit ratings have been adversely affected which has meant that the Council is no longer able to use the Bank of Scotland call account to invest surplus cash balances, and can only invest a maximum of £500k with Barclays Bank Plc across both the current and call account due to the banks credit rating having fallen below the levels recommended in the TMS. The Council is limited to using the DMO or other Local Authorities and monies have to be placed for a set period of time and cannot be redeemed if an emergency situation arises and the cash is required. In such cases the Council would go out to the market and borrow to cover the situation.
- 4.5 To help manage surplus funds and mitigate credit rating risk the Council is in the process of setting up facilities with Money Market Funds (MMF). This option is already outlined and approved as part of the TMS approved options to invest surplus cash in Fitch Rated AAA - Money Market Fund – Collective Limit £50m – Individual Limit 10m. Use of MMFs would enable the Council to help protect investment income from the reducing interest rates whilst providing mitigation of the exposure to counterparty risk.
- 4.6 The Council has continued to borrow to fund the capital programme. Loans have been arranged at interest rates to achieve budget certainty and for varying periods to fit in with the Councils debt maturity profile.
- 4.7 The Bank of England Monetary Policy Committee reduced the Base Rate to 0.25% in August 2016. This was the first change to interest rates since 2009. This reduction will have an impact on the cost of any new borrowing taken after this date as well as on income received from investing surplus cash balances.

5. CONSULTATION

- 5.1 The Council's Prudential Code and Treasury Management Strategy 2016-2026 has undergone full consultation and been through the scrutiny process as it forms part of the annual MTFS and Revised MTFS.
- 5.2 The Council continues to liaise with its treasury advisors, Capita Asset Services.

6. ANTICIPATED OUTCOMES

- 6.1 As set out in the report.

7. REASONS FOR RECOMMENDATIONS

- 7.1 This report is given to the Committee to review performance against the Prudential Indicators in the TMS set in the MTFS and Revised MTFS.

8. ALTERNATIVE OPTIONS CONSIDERED

The Prudential Code and Treasury Management Strategy 2016-2026 is required to be prepared in accordance with the Treasury Management in the Public Services: Code of Practice 2011. This report sets out the performance against the associated indicators. The options are therefore limited.

9. IMPLICATIONS

- 9.1 To provide the Committee the opportunity to review current performance against the revised Prudential Indicators.

Legal Implications

Treasury Management activities have to conform to the Local Government Act 2003, the Local Authorities (Capital; Finance and Accounting) (England) Regulations 2003 (SI 2003/3146), which specifies that the Council is required to have regard to the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice and also the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 (SI 2008/414), which clarifies the requirements of the Minimum Revenue Provision guidance.

10. BACKGROUND DOCUMENTS

(Used to prepare this report, in accordance with the Local Government (Access to Information) Act 1985)

- The Prudential Code for Capital Finance in Local Authorities –2011 Edition, CIPFA; and
- Treasury Management in the Public Services, Code of Practice and Cross-Sectoral Guidance Notes – 2011 Edition, CIPFA

11. APENDICES

- Treasury Management Strategy – Prudential Indicators – Forecast Outturn as at 30 September 2016.

Treasury Management Strategy – Prudential Indicators – Forecast Outturn as at 30 September 2016

The Prudential Code for Capital Finance in Local Authorities provides a framework for local authority capital finance to ensure that:

- (a) capital expenditure plans are affordable,
- (b) all external borrowing and other long term liabilities are within prudent and sustainable levels;
- (c) treasury management decisions are taken in accordance with professional good practice.

In taking decisions in relation to (a) and (c) above, the local authority is accountable by providing a clear and transparent framework.

The Code requires the Council to set a range of Prudential Indicators for the forthcoming financial year and at least the following two financial years. The Council has set out indicators for the next 10 financial years in line with setting a 10 year budget. During the financial year to date the Council has operated within the treasury limits and Prudential Indicators set out in the Council's Revised Annual Treasury Management Strategy. The actual and forecast outturn for the Prudential Indicators for the financial year is detailed below. The indicators include the Invest to Save scheme however the costs of borrowing associated with the scheme will be offset by the income generated by these projects.

The updated 2016/17 Prudential Indicators are shown below and the Council's performance to date against them. All performance is within the limits.

1. Indicator 1: Capital Expenditure

This indicator is the estimated capital expenditure for the year based on the Capital Programme for that period.

Capital Expenditure	2016/17 Indicator £m	2016/17 Actual @30.09.16 £m	2016/17 Forecast Outturn £m
Capital Expenditure	100.1	18.4	100.0
Invest to Save	56.5	5.2	68.5
Total	156.6	23.6	168.5

The position shows the forecast as at 30 September 2016. The forecast is revised every month. The forecast outturn is higher than the MTFs indicator due to the slippage of the Invest to Save and other capital budgets from 2015/16 to 2016/17, resulting from delays in progressing the planned schemes.

2. Indicator 2: Capital Financing Requirement (CFR)

The CFR measures the Council's underlying need to borrow money in the long term for capital purposes. Any capital expenditure which has not immediately been paid for will increase the CFR.

Capital Financing Requirement	2016/17 Indicator £m	2016/17 Actual @30.09.16 £m	2016/17 Forecast Outturn £m
CFR b/fwd	546.0	480.9	480.9
Underlying Need to Borrow	52.3	(0.6)	55.5
Underlying Need to Borrow - Invest to Save	60.0	4.6	67.9
Total CFR C/fwd	658.3	485.0	604.3

3. Indicator 3: Actuals and estimates of the ratio of financing costs to net revenue budget

The Council must estimate the proportion of the revenue budget, which is taken up in financing capital expenditure i.e. the net interest cost and to make provision to repay debt.

Ratio of net financing costs to net revenue stream	2016/17 Indicator	2016/17 Actual @30.09.16	2016/17 Forecast Outturn
Total Ratio	6.1%	5.5%	5.2%

4. Indicator 4: Actuals and estimates of the incremental impact of capital investment on Council Tax

This indicator is intended to show the impact of the Council's decisions about capital investment on the level of Council Tax required to support those decisions over the medium term.

The calculation of this indicator has been done on the basis of the amount of the capital programme that is financed from borrowing. The calculation is based on the interest assumption for borrowing that was included in the capital financing budget for the MTFS. The revenue costs are divided by the estimated Council Tax base for the year, and performance is shown in the table below.

Incremental impact on capital investment decisions on Council Tax	2016/17 Indicator	2016/17 Actual @30.09.16	2016/17 Forecast Outturn
Total Incremental Impact	(£197.70)	(£239.73)	(£262.38)

5. Indicator 5: Proportion of Gross Debt to the CFR

This indicator shows the proportion of the Council's external borrowings (Gross Debt) against the CFR.

Proportion of Gross Debt to the CFR	2016/17 Indicator	2016/17 Actual @30.09.16	2016/17 Forecast Outturn
	£m	£m	£m
CFR	658.4	485.0	604.3
Gross Debt	584.1	410.1	525.0
% of Gross Debt to CFR	88.7%	84.6%	86.9%

6. Indicator 6: The Operational Boundary

The Operational Boundary is a measure of the day to day likely borrowing for the Council. The code recognises that circumstances might arise when the boundary might be exceeded temporarily, but if this continues for a lengthy period then it ought to be investigated.

This indicator takes into consideration the capital programme over the life of the MTFS and the ability to phase the borrowing over this period. The indicator provides flexibility for the Council to take advantage of favourable interest rates in advance of the timing of the actual capital expenditure.

Operational Boundary	2016/17 Indicator	2016/17 Actual @30.09.16	2016/17 Forecast Outturn

	£m	£m	£m
Borrowing	690.9	371.7	486.6
Other Liabilities	38.6	38.4	38.4
Total Operational Boundary	729.5	410.1	525.0

7. Indicator 7: The Authorised Limit

The Authorised Limit represents the maximum amount the Council may borrow at any point in time in the year. It is set at a level the Council considers is “prudent”.

The indicator takes account of the capital financing requirement estimated at the start of each year, plus the expected net borrowing requirement for the year. This makes allowance for the possibility that the optimum time to do all borrowing may be early in the year.

The limits also incorporated margins to allow for exceptional short-term movements in the Council’s cash flow, bids from service departments to finance efficiencies, changes to the timing of capital payments and fluctuations in the realisation of capital receipts.

Authorised Limit	2016/17 Indicator £m	2016/17 Actual @30.09.16 £m	2016/17 Forecast Outturn £m
Borrowing	796.6	371.7	486.6
Other Liabilities	38.6	38.4	38.4
Total Authorised Limit	835.2	410.1	525.0

It is ultra vires to exceed the Authorised Limit so this should be set to avoid circumstances in which the Council would need to borrow more money than this limit. However, the Council can revise the limit during the course of the year. The forecast outturn is lower than the indicator as the Council does not currently anticipate borrowing in advance of need due to the additional cost of holding the funds until required.

8. Indicator 8: Fixed Interest rate exposure

This indicator places an upper limit on the total amount of net borrowing which is at fixed rates secured against future interest rate movements. The upper limit allows flexibility in applying a proportion of the investment portfolio to finance new capital expenditure. It also reflects a position where the majority of borrowing is at fixed rate which provides budget certainty with 100% of borrowing being at fixed rate. The upper limit for fixed interest rate exposure was set to allow for flexibility in applying a proportion of the investment portfolio to finance new capital expenditure. It also reflected a position where the majority of borrowing was at fixed rates to provide budget certainty.

Upper limit for fixed rate exposure	2016/17 Indicator £m	2016/17 Actual @30.09.16 £m	2016/17 Forecast Outturn £m
Upper Limit	796.6	410.1	525.0
% of fixed interest rate exposure	100%	100%	100%

9. Indicator 9: Variable interest rate exposure

This indicator places an upper limit on the total amount of net borrowing (borrowing less investment) which is at variable rates subject to interest rate movements. The intention is to keep the variable rate borrowing below 25% of the total gross borrowing (CFR).

The limit is expressed as the value of total borrowing less investments

Upper limit for variable rate exposure	2016/17 Indicator £m	2016/17 Actual @30.09.16 £m	2016/17 Forecast Outturn £m
Upper Limit	199.2	0.0	0.0
% of variable interest rate exposure	25%	25%	25%

The indicator for actual and forecast outturn is zero due to the current borrowing strategy of borrowing only at a fixed interest rate in the current economic climate of volatile interest rates. Borrowing at fixed interest rates provides budget certainty for the Council.

10. Indicator 10: Maturity structure of borrowing

The prudential limits have been set with regard to the maturity structure of the Council's borrowing, and reflected the relatively beneficial long term rates that were expected to be available over the next few years. The borrowing that the Council has actually taken up to the end of September is £371.7m (shown in the indicator below).

Period	Upper Limit Indicator	Actual Borrowing @30.09.16	Actual Borrowing @30.09.16 £m
Under 12 months*	40%	5%	18.3
1 – 2 years	40%	4%	16.0
2 – 5 years	80%	7%	25.0
5 – 10 years	80%	5%	20.1
Over 10 years	100%	79%	292.3
Total Borrowing			371.7

* The borrowing for under 12 months includes £17.5m of Lenders Option Borrowers Option (LOBO) loans. Although the loans are due to mature in 30-40 years time, they are classed as loans repayable within the financial year due to LOBO's having a call-in date every 6 months.

Although this table is not a Prudential Indicator it gives a breakdown of the types of borrowing held by the Council and the average interest rates for each:

Borrowing	31 Mar 2016		30 Sep 2016	
	Amount (£m)	Average Interest Rate	Amount (£m)	Average Interest Rate
Long Term:				
Public Works Loan Board	282.4	3.90%	312.9	3.76%
Market Loans	17.5	4.53%	17.5	4.53%
Local Enterprise Partnership	3.8	0.00%	3.8	0.00%
Short Term:				
Local Authorities	59.5	1.58%	37.5	1.86%
Total 'Market' Borrowing	363.2		371.7	
Public Finance Initiative & Leases	38.4		38.4	
Total Borrowing	401.6		410.1	

11. Indicator 11: Total Investments for periods longer than 364 days

Authorities are able to invest for longer than 364 days; this can be advantageous if higher rates are available. However it would be unwise to lend a disproportionate amount of cash for too long a period particularly as the Council must maintain sufficient working capital for its operational needs.

	2016/17 Indicator £m	2016/17 Actual @30.09.16 £m	2016/17 Forecast Outturn £m
Principal sums invested >364 days	10.0	0.0	0.0

This indicator reflects the Council's current lending policy of keeping investments short term for liquidity purposes. Also the Council has run down its cash balances as an alternative to new borrowing and does not have the available cash balances to invest for long periods.

The indicator was set at £10m to allow for the accounting treatment of the Local Authority Mortgage Scheme (LAMS). At present the Council has £2m deposited in the LAMS scheme with Lloyds TSB and this is treated as capital expenditure, as a loan to a third party, (see section 3.5 of the TMS). There is currently no plan to extend this initiative. The Council's external auditors highlighted in a previous Statement of Accounts report that there was some debate about the accounting treatment for LAMS. Whilst the Council is confident of its accounting treatment as a capital loan, if the accounting treatment changed for this deposit for to be classed as an investment then this indicator would cover this investment.