AUDIT COMMITTEE	AGENDA ITEM No. 6
9 NOVEMBER 2015	PUBLIC REPORT

Committee Member(s) responsible:	Resources portfolio holder, Cllr Seaton	
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TREASURY MANAGEMENT MID YEAR UP-DATE

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 polices, 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 and the final performance against the strategy is reported to Audit Committee in June alongside the Statement of Accounts. This report forms the mid-year review.

2. PURPOSE AND REASON FOR REPORT

2.1 To report current performance and the forecast outturn position against the strategy.

2.2 This is in accordance with the Committees' Terms of Reference – 2.2.1.16 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 2015/16 Prudential Indicators are shown in Appendix 1. The Council's performance to date and forecast performance are all within the limits set in the 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 (maximum £5m), Bank of Scotland (part of the Lloyds Banking Group, maximum £5m), other Local Authorities and the Debt Management Office (DMO).

4.4 In June 2015, Barclays was downgraded by a major credit reference agency to A-2 for short term investments. In accordance with the TMS, surplus funds were immediately withdrawn from Barclays and invested with the DMO as this rating fell below minimum requirements. Overall, governance in the banking sector has improved significantly, therefore it is not anticipated that the downgrading will be long term and funds will be re-invested with Barclays as soon as the rating returns to an acceptable level.

4.5 The ratings from all three credit rating agencies for the Bank of Scotland meet the minimum criteria set out in the Treasury Strategy, per the MTFS. It is used to invest cash on an instant access basis to ensure cash is kept liquid to cover cash flow fluctuations. Daily treasury management practices therefore concentrate on short term cash flow requirements and long term borrowing needs.

4.6 The Council has continued to borrow to fund the capital programme. Loans have been arranged at varying interest rates to achieve budget certainty and for varying periods to fit in with the Councils debt maturity profile.

5. CONSULTATION

5.1 The Council's Prudential Code and Treasury Management Strategy 2015-2025 has undergone full consultation and been through the scrutiny process as it forms part of the annual 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 and update is given to the Committee to review performance against the TMS set in the MTFS.

8. ALTERNATIVE OPTIONS CONSIDERED

8.1 The 'The Prudential Code and Treasury Management Strategy 2015-2025' 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.

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. APPENDICES

11.1 Appendix A - Treasury Management Strategy-Prudential Indicators – Forecast Outturn as at 30th September 2015.

Treasury Management Strategy – Prudential Indicators – Forecast Outturn as at 30th September 2015

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 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 2015/16 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	2015/16 Indicator	2015/16 Actual @30.09.15	2015/16 Forecast Outturn
Capital Expenditure	£86.3m	£29.4m	£108.4m
Invest to Save	£54.8m	£0.4m	£91.9m
Total	**£141.1m**	**£29.8m**	**£200.3m**

The position shows the forecast as at 30th September 2015. The forecast is revised every month. The forecast outturn is higher than the MTFS indicator due to the slippage of the capital budgets from 2014/15 to 2015/16.

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	2015/16 Indicator	2015/16 Actual @30.09.15	2015/16 Forecast Outturn
CFR b/fwd	£482.9m	£422.5m	£422.5m
Underlying Need to Borrow	£45.1m	£13.4m	£61.6m
Underlying Need to Borrow - Invest to Save	£54.8m	£0.4m	£91.9m
Total CFR C/fwd	**£582.8m**	**£436.3m**	**£576.0m**

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	2015/16 Indicator	2015/16 Actual @30.09.15	2015/16 Forecast Outturn
Total Ratio	7.6%	7.2%	7.4%

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	2015/16 Indicator	2015/16 Actual @30.09.15	2015/16 Forecast Outturn
A – Cap Fin Budget -Previous MTFS	£29.275m	£29.275m	£29.275m
B – Cap Fin Budget - Current	£23.567m	£21.908m	£22.597m
C - Incremental change (B-A)	(£5.708m)	(£7.367m)	(£6.678m)
D - Council Tax Base (1,000's)	52.75	52.75	52.75
Total Incremental Impact (C/D)	(£108.21)	(£139.66)	(£126.60)

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	2015/16 Indicator	2015/16 Actual @30.09.15	2015/16 Forecast Outturn
CFR	£582.9m	£436.3m	£576.0m
Gross Debt	£513.5m	£351.1m	£497.6m
% of Gross Debt to CFR	**88.1%**	**80.5%**	**86.4%**

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	**2015/16 Indicator**	**2015/16 Actual @30.09.15**	**2015/16 Forecast Outturn**
Borrowing	£648.0m	£313.0m	£459.5m
Other Long Term Liabilities	£38.5m	£38.1m	£38.1m
Total Operational Boundary	**£686.5m**	**£351.1m**	**£497.6m**

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	**2015/16 Indicator**	**2015/16 Actual @30.09.15**	**2015/16 Forecast Outturn**
Borrowing	£682.4m	£313.0m	£459.5m
Other Long Term Liabilities	£38.5m	£38.1m	£38.1m
Total Authorised Limit	**£720.9m**	**£351.1m**	**£497.6m**

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	**2015/16 Indicator**	**2015/16 Actual**	**2015/16 Forecast**

		@30.09.15	Outturn
Upper Limit	£720.9m	£313.0m	£459.5m
% 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	2015/16 Indicator	2015/16 Actual @30.09.15	2015/16 Forecast Outturn
Upper Limit	£180.2m	£0.0m	£0.0m
% 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 £313.0m (shown in the indicator below).

Period	Upper Limit Indicator	Actual Borrowing @30.09.15	Actual Borrowing @30.09.15
Under 12 months*	40%	12%	£38.5m
1 – 2 years	40%	2%	£7.0m
2 – 5 years	80%	11%	£33.1m
5 – 10 years	80%	5%	£15.1m
Over 10 years	100%	70%	£219.3m
		Total Borrowing	**£313.0m**

* 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 2015		30 Sep 2015	
	Amount (£m)	Average Interest Rate	Amount (£m)	Average Interest Rate
Long Term:				
Public Works Loan Board	234.4	4.09%	234.4	4.09%
Market Loans	17.5	4.53%	17.5	4.53%
Local Enterprise Partnership	3.1	0.00%	3.1	0.00%
Short Term:				
Local Authorities	51.0	1.58%	58.0	1.56%
Total 'Market' Borrowing	**306.0**		**313.0**	
Public Finance Initiative & Leases	40.4		38.1	
Total Borrowing	**346.4**		**351.1**	

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.

	2015/16 Indicator	2015/16 Actual @30.09.15	2015/16 Forecast Outturn
Principal sums invested >364 days	£6.0m	£0.0m	£0.0m

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 over the last three financial years as an alternative to new borrowing and does not have the available cash balances to invest for long periods.

The indicator was set at £6m 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.

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