AUDIT COMMITTEE	AGENDA ITEM No. 5
26 JUNE 2017	PUBLIC REPORT

Report of:	John Harrison, Corporate Director: Resources	
Cabinet Member(s) responsible:	Cllr Seaton Portfolio Holder for Resources	
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CAPITAL AND TREASURY OUTTURN 2016/17

R E C O M M E N D A T I O N S	
FROM: Corporate Director : Resources	**Deadline date:** *N/A*
It is recommended that Audit Committee: 1. Note the 2016/17 Capital Outturn; and 2. Note the compliance with Prudential Indicators achieved.	

1. ORIGIN OF REPORT

1.1 This report is submitted to the Audit Committee as part of the annual financial reporting cycle

2. PURPOSE AND REASON FOR REPORT

2.1 The purpose of this report is to enable consideration of 2016/17 capital outturn and to monitor adherence to Prudential Indicators.

2.2 This report is for Audit Committee to consider under its Terms of Reference No. 2.2.1.1 “To consider the annual report and opinion of the Corporate Director Resources and a summary of internal audit activity (actual and proposed) and the level of assurance it can give over the Council’s corporate governance arrangements.

3. TIMESCALES

Is this a Major Policy Item/Statutory Plan?	**NO**

4. CAPITAL

4.1 The planned capital programme for the financial year was £156.7m. Slippage of expenditure from 2015/16 of £81.6m increased the agreed budget at 1 April 2016 to £238.3m. Throughout the year the capital programme was regularly reviewed and finally reduced to £75.5m through slippage and savings. Much of the slippage has been built into future budgets as part of setting the 2017/18 budget.

4.2 Capital expenditure during 2016/17 totalled £76.8m as shown in the summary table below:

Capital Programme 2016/17 by Directorate	Budget 01/04/2016 £000	Revised Budget £000	Actual £000
Governance	49	-	-
Growth & Regeneration	37,560	23,803	23,918
People & Communities	49,624	26,024	27,632
Resources	24,368	6,581	6,179
Invest to Save	126,661	19,048	19,107
Total	**238,262**	**75,457**	**76,835**
Financed by:			
External Sources	44,715	34,810	35,904
Capital Receipts	1,000	-	1,000
Prudential Borrowing	192,547	40,646	39,931
Total	**238,262**	**75,457**	**76,835**

4.3 The Council and CMT have agreed to reduce and re-phase some projects in the programme during the year to reduce the impact on financial resources or to reflect changing demographic needs. Other projects have been subject to delays which have led to budgets being slipped to 2017/18. Listed below are the significant projects that have been slipped into 2017/18 that has contributed to the variance between the revised budget reported in December 2016 and the reported capital programme outturn of £76.8m.

Growth & Regeneration
- £ 2.6m Street Lighting projects
- £ 2.m Housing Joint Venture
- £ 6.2m Roads & Bridges/Transport projects
- £ 2.1m Public Realm Projects

Resources
- £ 7.4m ICT Projects
- £ 0.7m Renewable Energy projects
- £ £5.2m Fletton Quays Fit Out
- £3.4m Householders Recycling Centre
- £1m London Road Fit Out

People & Communities
- £6.9m Jack Hunt Expansion
- £7.2m Hampton Leys (Gardens)
- £3.7m Paston Reserve Primary
- £3.7m Clare Lodge Phase 6
- £0.5m Adult Social Care Transformation

Invest to Save
- £2.8m Axiom Loan
- £66.1m Empower Loan
- £2.1m Invest To Save

4.4 The Invest to Save outturn of £19.1m in 2016/17 includes expenditure on delivering energy efficiency measures across the council's buildings portfolio including schools. The schemes are self-funding in two ways:

a. Firstly, introducing energy efficiency measures through the replacement of plant inside the buildings driving down energy costs (for example in our swimming pools through new filters and a combined heat and power unit for the regional pool, more efficient lighting in car parks and replacing school boilers).

b. Secondly, putting solar panels on roofs to provide a cheaper source of energy for the buildings and an income stream by selling surplus energy to the grid (including schools).

4.5 The Invest to Save outturn also includes the investment the Council has made in its strategic partnership with Empower Community Management LLP (EC), a social enterprise company that has, as its primary purpose, the installation of solar panels on residential properties. This scheme is the first scheme of its type in the UK and in particular the first of its kind that involves a Council. The major benefits of the scheme are:

- No cost to the owner for installation
- Free energy generated to the occupier
- A fee for installation paid to the owner
- Creation of a local community fund out of profits
- A fee to the Council out of profits generated
- Investment returns generated by the Council

4.6 The capital programme is financed through borrowing, capital receipts, grants and contributions. Although the amount of borrowing required has reduced due to slippage in the capital programme since the MTFS was approved, the Council would need to borrow £39.9m to fund 2016/17 capital expenditure although the actual Council borrowing was £32.4m as reported in paragraph 5.3b.

5. TREASURY MANAGEMENT ACTIVITY FOR 2016/17

5.1 The Council is required to operate a balanced budget, which means that cash raised through the year will meet cash expenditure. The role of treasury management is to ensure cash flow is adequately planned so that cash is available when it is needed. Surplus monies are invested in low risk counterparties commensurate with the Council's low risk appetite ensuring that security and liquidity are achieved before considering investment return.

5.2 Another role of treasury management is to fund the Council's capital programme. The programme provides a guide to the borrowing needs of the Council and the planning of a longer term cash flow to ensure capital obligations are met. The management of long term cash may involve arranging short or long term loans or using longer term cash flow surpluses.

5.3 The treasury activity for the Council during 2016/17 is compliant with the Treasury Management Strategy approved in March 2016. Investment and borrowing activities include:

a. Investment – The Council aims to achieve the optimum return (yield) on investments commensurate with the proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term and only invest with Barclays (the Council's current banking provider), the Debt Management Office and Local Authorities. As at 31 March 2017 the Council's external investments totalled £13.6m and have yielded interest at an average rate of 0.25% in the financial year 2016/17. Investments were placed for short periods to cover daily cash flow fluctuations but longer term investments in Solar Bonds are being considered.

b. Borrowing – In 2016/17 the Council increased its borrowing by £32.4m. Although £39.9m was required to fund the capital programme, due to timing issues surplus cash balances were utilised to off-set the actual borrowing requirement in the year. The borrowing has been taken out over a range of periods to best fit the Council's maturity profile of debt. Also the best possible interest rate has been sought in line with the budget for borrowing, including the continuation of the council benefitting from reduced interest rates on long term PWLB loans by 20 basis points (0.2%) due to it submitting borrowing plans to government.

c. Consideration has been made to rescheduling debt however there have been no suitable opportunities to do this. The difference between the repayment rate and the rate of a new loan has not resulted in a net discount to the Council and no savings were to be made.

5.4 The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow money in the long term for capital purposes. In accordance with the 2016/17 Code the liability for the Private Finance Initiative (PFI) agreement and finance leases also impact on the CFR.

5.6 In 2016/17 the CFR was:

Capital Financing Requirement	**£000**
Opening Capital Financing Requirement 1 April 2016	480,939
New Capital Expenditure Financed by Borrowing	39,931
Minimum Revenue Provision for Debt Repayment	(10,087)
Minimum Revenue Provision for PFI	(376)
Minimum Revenue Provision for Leases	(636)
Closing Capital Financing Requirement 31 March 2017	**509,771**

5.7 As part of the setting of the treasury strategy, the Council sets annual prudential indicators to measure effectiveness of treasury management and reports against these indicators during the financial year. The Council has operated within its indicators during 2016/17.

5.8 Further information on the Council's capital financing arrangements can be found in the Prudential Indicators performance found in **Appendix A** along with an update on treasury management activity and other financial performance indicators in **Appendix B**.

6. CONSULTATION

6.1 Detailed reports have been discussed in Departmental Management Teams and this report with the Corporate Management Team.

7. ANTICIPATED OUTCOMES OR IMPACT

7.1 That the outturn position for 2016/17 is noted.

8. REASON FOR THE RECOMMENDATION

8.1 This monitoring report forms part of the 2016/17 closure of accounts and informs the draft Statement of Accounts on this Agenda.

9. ALTERNATIVE OPTIONS CONSIDERED

9.1 None, this is an annual financial report, that has to be presented to Committee.

10. IMPLICATIONS

Financial Implications

10.1 These are set out in the body of the report.

Legal Implications

10.2 This report adheres to the principles of good governance and the Local Government Finance Act 2012 would apply.

Equalities Implications

10.3 There are none.

11. BACKGROUND DOCUMENTS

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

11.1 The 2016/17 Medium Term Financial Strategy

12. APPENDICES

A**-** Treasury Management Strategy – Prudential Indicators – 2016/17
B - Treasury Management Update – March 2017

Appendix A – Treasury Management Strategy – Prudential Indicators – 2016/17

1. 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.

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

3. The Code requires the Council to set a range of Prudential Indicators for the next 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. 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.

4. During 2016/17 the Council has operated within the treasury limits and Prudential Indicators set out in the Council's Annual Treasury Management Strategy.

5. The Council's outturn performance position against the 2016/17 Prudential Indicators are shown below.

Indicator 1: Capital Expenditure

This indicator is the actual capital expenditure for the year based on the Capital Programme in 2016/17.

Capital Expenditure	**2016/17 Indicator £m**	**2016/17 Actual £m**
Capital Expenditure	100.0	57.7
Invest to Save	56.6	19.1
Total	**156.6**	**76.8**

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 £m**
CFR brought forward	546.0	480.9
Underlying Need to Borrow	52.3	9.8
Underlying Need to Borrow - Invest to Save	60.0	19.1
Total CFR carried forward	**658.3**	**509.8**

Indicator 3: Estimates and Actuals for 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. This is the proportion of the budget allocated to 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
Total Ratio	6.1%	6.1%

Indicator 4: Estimates and Actuals 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 and 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 the actual performance is shown in the table below.

Incremental impact on capital investment decisions on Council Tax	2016/17 Indicator £m	2016/17 Actual £m
A – Cap Fin Budget -Previous MTFS	28,889	28,889
B – Cap Fin Budget - Current	18,193	17,551
C - Incremental change (B-A)	(10,695)	(11,338)
D - Council Tax Base (1,000's)	54.10	54.10
Total Incremental Impact (C/D)	**(197.70)**	**(209.75)**

The incremental change of £15.5m shown in the table is largely the result of the 2016/17 MTFS where the Council agreed to revise the 2015/16 MRP policy.

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 £m	2016/17 Actual £m
CFR	658.4	509.8
Gross Debt	584.1	430.9
% of Gross Debt to CFR	**88.7%**	**84.5%**

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 £m	2016/17 Actual £m
Borrowing	690.9	395.3
Other Long Term Liabilities	38.6	35.6
Total Operational Boundary	**729.5**	**430.9**

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 £m
Borrowing	796.6	395.3
Other Long Term Liabilities	38.6	35.6
Total Authorised Limit	**835.2**	**430.9**

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 actual outturn is lower than the indicator as the Council did not need to borrow in advance of need during 2015/16.

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 £m
Upper Limit - Borrowing	796.6	430.9
% of fixed interest rate exposure	100%	100%

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 £m
Upper Limit	199.2	-
% of variable interest rate exposure	25%	25%

The indicator for actual 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 and also provides budget certainty for the Council.

Indicator 10: Maturity structure of borrowing

The prudential limits have been set with regard to the maturity structure of the Council's borrowing, and reflects the beneficial long term rates that are available to the Council.

Period	Upper Limit Indicator	Actual Borrowing	Actual Borrowing £m
Under 12 months*	40%	4.8%	18.8
1 – 2 years	40%	2.2%	8.9
2 – 5 years	80%	6.3%	25.0
5 – 10 years	80%	4.1%	16.1
Over 10 years	100%	82.6%	326.4
		Total 'Market' Borrowing	**395.3**

** 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 classified 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 March 2016		31 March 2017	
	Amount £m	Average Interest Rate	Amount £m	Average Interest Rate
Long Term:				
Public Works Loan Board	282.4	3.90%	329.5	3.68%
Market Loans	17.5	4.53%	17.5	4.53%
Short Term:				
Local Authorities	59.5	1.44%	44.5	1.63%
Other Borrowing:				
Local Enterprise Partnership	3.8	0.00%	3.8	0.00%
Total 'Market' Borrowing	**363.2**		**395.3**	
Public Finance Initiative & Leases	38.9		35.6	
Total Borrowing	**402.1**		**430.9**	

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.

Interest Rate Exposure (Upper Limits)	2016/17 Indicator £m	2016/17 Actual £m
Principal sums invested >364 days	10.0	-

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 over the last three financial years as an alternative to new borrowing and does not have the avaiable 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.

Appendix B – Performance Monitoring

1. Treasury Management Update – March 2017

1.1 Economic Update

The following paragraphs are based on information from the Council's Treasury Advisors (Capita Asset Services)

The two major landmark events that had a significant influence on financial markets in the 2016-17 financial year were the UK EU referendum on 23 June and the election of President Trump in the USA on 9 November. The first event had an immediate impact in terms of market expectations of when the first increase in Bank Rate would happen, pushing it back from quarter 3 2018 to quarter 4 2019. At its 4 August meeting, the Monetary Policy Committee (MPC) cut Bank Rate from 0.5% to 0.25% and the Bank of England's Inflation Report produced forecasts warning of a major shock to economic activity in the UK, which would cause economic growth to fall almost to zero in the second half of 2016. The MPC also warned that it would be considering cutting Bank Rate again towards the end of 2016 in order to support growth. In addition, it restarted quantitative easing with purchases of £60bn of gilts and £10bn of corporate bonds, and also introduced the Term Funding Scheme whereby potentially £100bn of cheap financing was made available to banks.

In the second half of 2016, the UK economy confounded the Bank's pessimistic forecasts of August. After a disappointing quarter 1 of only +0.2% GDP growth, the three subsequent quarters of 2016 came in at +0.6%, +0.5% and +0.7% to produce an annual growth for 2016 overall, compared to 2015, of no less than 1.8%, which was very nearly the fastest rate of growth of any of the G7 countries. Needless to say, this meant that the MPC did not cut Bank Rate again after August but, since then, inflation has risen rapidly due to the effects of the sharp devaluation of sterling after the referendum. By the end of March 2017, sterling was 17% down against the dollar but had not fallen as far against the euro. In February 2017, the latest CPI inflation figure had risen to 2.3%, above the MPC's inflation target of 2%. However, the MPC's view was that it would look through near term supply side driven inflation, (i.e. not raise Bank Rate), caused by sterling's devaluation, despite forecasting that inflation would reach nearly 3% during 2017 and 2018. This outlook, however, is dependent on domestically generated inflation, (i.e. wage inflation), continuing to remain subdued despite the fact that unemployment is at historically very low levels and is on a downward trend. Market expectations for the first increase in Bank Rate moved forward to quarter 3 2018 by the end of March 2017 in response to increasing concerns around inflation.

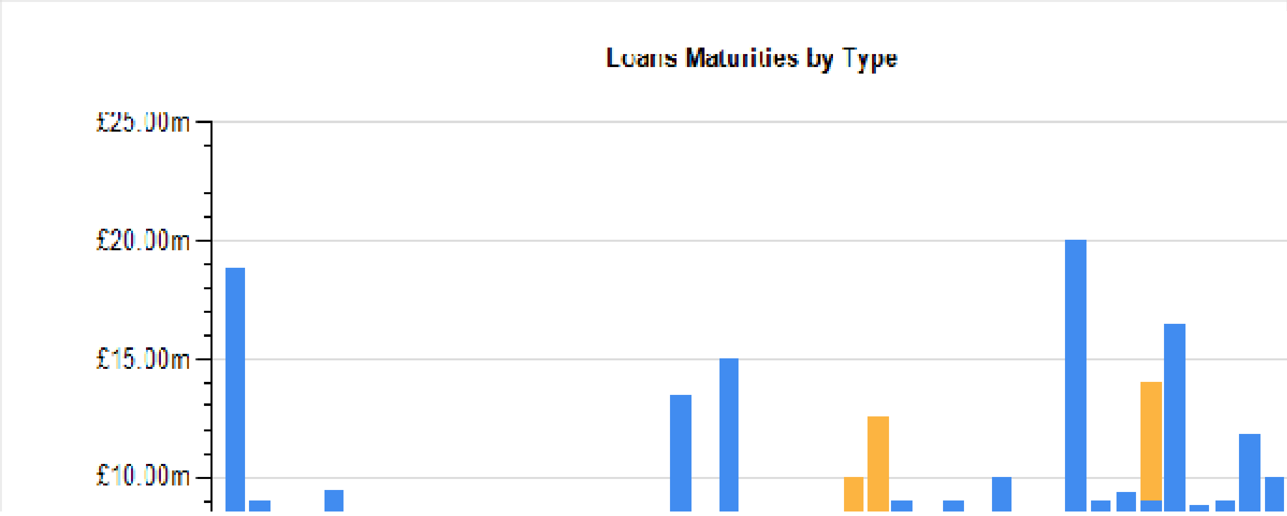
The result of the referendum, and the consequent devaluation of sterling, boosted the shares of many FTSE 100 companies which had major earnings which were not denominated in sterling. The overall trend since then has been steeply upwards and received further momentum after Donald Trump was elected President as he had promised a major fiscal stimulus to boost the US economy and growth rate.

2. Borrowing

2.1. It is a statutory duty for the Council to determine and keep under review the "Affordable Borrowing Limits". The Council's approved Prudential Indicators (affordability limits) are outlined in the approved Treasury Management Strategy.

2.2. The Council's borrowing as at 31 March 2017 was £430.9m. The actual total external debt is measured against the Council's Authorised Limit for borrowing of £835.2m, which must not be exceeded and the Operational Boundary (maximum working capital borrowing indicator) of £729.5m. The table in Appendix B, Indicator 10 shows a breakdown of the borrowing.

2.3. The following chart shows the maturity profile of the Council's debt as at 31 March 2017:



** 2016/17 includes £17.5m of market loans which are repayable in the long term but are classed as current year loans due to a callable option in the loan agreement.*

3. Investments

3.1. The Council aims to achieve the optimum return (yield) on investments commensurate with the proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term, and only invest with Barclays (the Council's banking provider), Bank of Scotland, the Debt Management Office and Local Authorities.