

SOUTH HOLLAND DISTRICT COUNCIL

Report of: Executive Director Commercialisation (S151), Julie Kennealy

To: Governance and Audit Committee 28 July 2016

Author: Sean Howsam – Finance Manager – Treasury (CPBS)

Subject: Annual Treasury Management Review 2015/16

Purpose: To consider the Annual Treasury Management Review for 2015-16 prior to it being presented to Council

Recommendation(s):

- 1) That the Governance and Audit Committee scrutinise the Annual Treasury Management Review 2015/16 and make any comments for consideration by Council when they consider this document at their meeting on 14 September 2016.
- 2) That the proposed changes to the Treasury Management Policy be noted and future work plans be amended to include a review of status at each meeting of the committee

1.0 BACKGROUND

1.1 This Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2015/16. This report 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).

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

- an annual treasury strategy in advance of the year (Council 25/02/2015);
- a mid year (minimum) treasury update report (submitted to Governance and Audit 03/12/2015);
- An annual review following the end of the year describing the activity compared to the strategy (this report).

1.2 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 Council's policies previously approved by members.

1.3 In compliance with the requirements under the Code, the treasury management reports are being submitted to the Governance and Audit Committee for scrutiny prior to being reported to the full Council.

1.4 The Treasury Management function is administered by Compass Point Business Services on behalf of the Council.

2.0 INTRODUCTION

2.1 This report summarises the following :-

- Capital activity during the year;
- Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement);
- The actual prudential and treasury indicators;
- Overall treasury position identifying how the Council has borrowed in relation to its indebtedness, and the impact on investment balances;
- Summary of interest rate movements in the year;
- Detailed debt activity; and
- Detailed investment activity.

3.0 THE COUNCIL'S CAPITAL EXPENDITURE AND FINANCING 2015/16

3.1 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.

3.2 The actual capital expenditure forms one of the required prudential indicators. The following tables show the actual capital expenditure and how this was financed.

£'000 General Fund	2014/15 Actual	2015/16 Estimate	2015/16 Actual
Capital expenditure	2,863	2,156	1,971
Financed in year	(1,356)	(2,156)	1,971
Unfinanced capital expenditure	1,507	-	-

£'000 Housing Revenue Account (HRA)	2014/15 Actual	2015/16 Estimate	2015/16 Actual
Capital expenditure	5,815	7,256	4,449
Financed in year	(5,815)	(7,256)	4,449
Unfinanced capital expenditure	-	-	-

4.0 THE COUNCIL'S OVERALL BORROWING NEED

4.1 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 indebtedness. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represents the 2015/16 unfinanced capital expenditure (see above table), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

4.2 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 that 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 (PWLb) or the money markets), or utilising temporary cash resources within the Council.

4.3 Reducing the CFR – the Council's (non HRA) 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 a repayment of the non-HRA borrowing need (there is no statutory requirement to reduce the HRA CFR). This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

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).

4.4 The Council's 2015/16 MRP Policy as required by Communities and Local Government (CLG) guidance was approved as part of the Treasury Management Strategy Report for 2015/16 on 25/02/2015.

4.5 The Council's CFR for the year is shown below, and represents a key prudential indicator:

CFR (£'000): General Fund	31 March 2015 Actual	31 March 2016 Budget	31 March 2016 Actual
Opening Balance	741	2,237	2,211
Add unfinanced capital expenditure (as above)	1,507	-	-
Less MRP/VRP and other financing movements	(37)	(254)	(1,903)
Closing Balance	2,211	1,983	308

Note: Minimum Revenue Provision contributions will be nil in 2016/17 and each year thereafter unless the CFR increases.

CFR (£'000): HRA	31 March 2015 Actual	31 March 2016 Budget	31 March 2016 Actual
Opening Balance	69,653	69,411	69,606
Add unfinanced capital expenditure (as above)	-	-	-
Less MRP/VRP and other financing movements	(47)	(246)	(23)
Closing Balance	69,606	69,165	69,583

Borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit.

- 4.6 Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the CFR in the preceding year (2015/16) plus the estimates of any additional CFR for the current (2016/17) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs in 2015/16. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

	31 March 2015 Actual (£'000)	31 March 2016 Budget (£'000)	31 March 2016 Actual (£'000)
Gross Borrowing Position	67,456	67,456	67,456
CFR	71,817	71,148	69,891

- 4.7 The authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level. The following table demonstrates that during 2015/16 the Council has maintained gross borrowing within its authorised limit.

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.

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 obligation costs net of investment income) against the net revenue stream.

	2015/16
Authorised limit	£90.456m
Maximum gross borrowing position	£67.456m
Operational boundary	£87.456m
Average gross borrowing position	£67.456m
Financing costs as a proportion of net revenue stream – Non HRA HRA	12.44% 27.05%

5.0 TREASURY POSITION AS AT 31 MARCH 2016

5.1 The Council's debt and investment position is organised by the treasury management service in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through member reporting and through officer activity detailed in the Council's Treasury Management Practices. At the beginning and the end of 2015/16 the Council's treasury position including accrued interest was as follows:

	31/3/15 Amount £'000	Rate/ Return %	Average Life	31/3/16 Amount £'000	Rate/ Return %	Average Life
Fixed rate funding						
PWLB	67,456	3.48	47 years	67,456	3.48	46 years
Leases	13	n/a		-	n/a	
Total debt	67,469	3.48	47 years	67,456	3.48	46 years
CFR	71,817			69,891		
Over/(under) borrowing	(4,348)			(2,435)		
Cash and investments:						
long term	(50)	n/a	n/a	(50)	n/a	n/a
short term	(14,315)	0.84	119 days	(21,027)	0.91	165 days
instant access deposits	(9,091)	0.44	1 day	(6,571)	0.48	1 day
Total cash and investments	(23,456)	0.69	73 days	(27,648)	0.80	124 days
Net debt	44,013			39,808		

5.2 Investments held at 31 March 2016 including accrued interest were as follows:

Financial Institution	Amount £'000	Start Date	Maturity Date	Rate/ Return %
Local Capital Finance Company Ltd	50	n/a	n/a	n/a
National Westminster Bank (Instant Access)	2	n/a	n/a	0.25
Svenska Handelsbanken	2,967	n/a	n/a	0.48
CCLA Money Market Fund	3,601	n/a	n/a	0.49
Lloyds Bank	1,717	09/04/15	07/04/16	1.00
Nationwide Building Society	1,003	14/10/15	14/04/16	0.66
Lloyds Bank – Thornfields S106	248	31/03/16	28/04/16	0.28
Nationwide Building Society	1,003	04/11/15	04/05/16	0.66
Goldman Sachs	3,507	05/01/16	05/07/16	0.785
Royal Bank of Scotland	3,020	31/07/15	29/07/16	0.97
Royal Bank of Scotland	1,509	14/08/15	12/08/16	0.97
Toronto Dominion Bank	4,013	03/12/15	01/12/16	0.92
Helaba Bank	3,006	13/01/16	13/01/17	1.00
Helaba Bank	2,002	01/03/16	28/02/17	0.95
TOTAL	27,648			

5.3 As at 31 March 2016 the maturity structure of the investment portfolio was all under one year with the exception of the £50,000 to the Local Capital Finance Company Ltd which has been created by the Municipal Bonds Agency. The whole of the borrowing is due for repayment on 28 March 2062.

5.4 All borrowing is at fixed rates and cash/investment holdings are split £21.027m fixed and £6.571m variable.

6.0 THE STRATEGY FOR 2015/16

6.1 The expectation for interest rates within the strategy for 2015/16 anticipated low but rising Bank Rate (starting in quarter 1 of 2016), and gradual rises in medium and longer term fixed borrowing rates during 2016/17. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period. Continued uncertainty in the aftermath of the 2008 financial crisis promoted a cautious approach, whereby investments would continue to be dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

6.2 In this scenario, the treasury strategy was to postpone borrowing to avoid the cost of holding higher levels of investments and to reduce counterparty risk.

7.0 THE ECONOMY AND INTEREST RATES

7.1 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.

7.2 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 also reflected in bond yields. However, the overall dominant trend in bond yields since July 2015 has been for them 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.

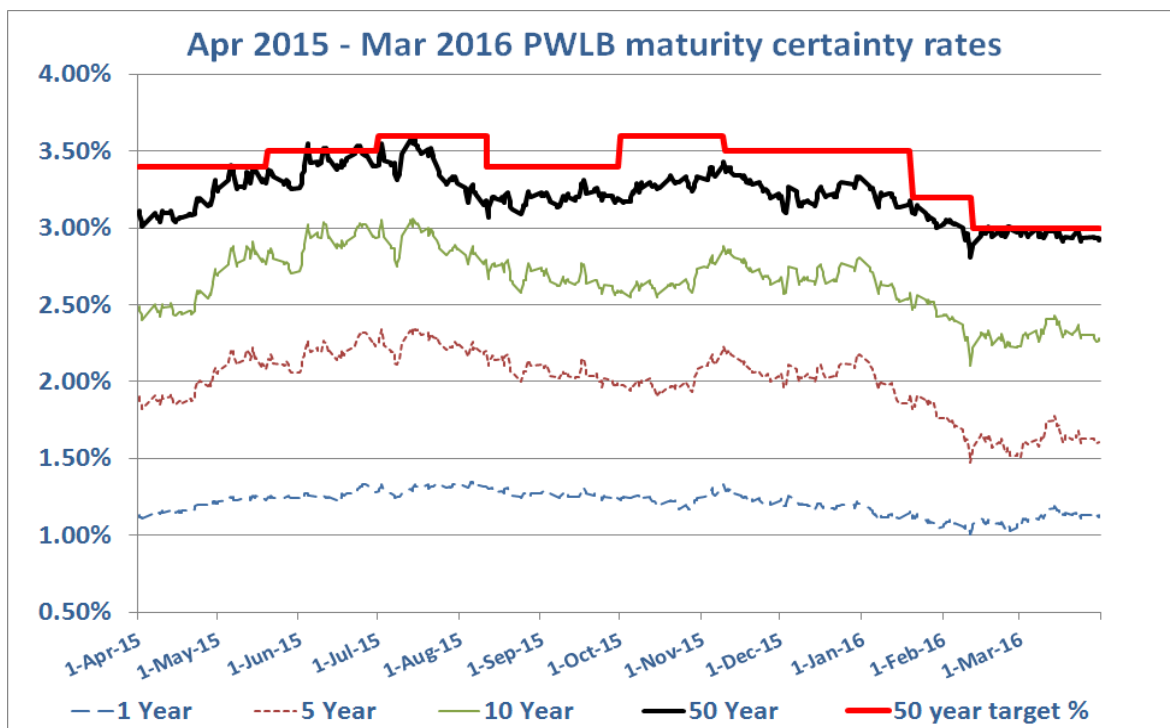
7.3 The European Central Bank (ECB) commenced a full blown quantitative easing programme of purchases of Eurozone government and other bonds starting in March at €60bn per month. This put downward pressure on Eurozone bond yields. There was a further increase in this programme of Quantitative Easing in December 2015.

7.4 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.

7.5 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 European Union. 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.

8.0 BORROWING RATES IN 2015/16

8.1 PWLB certainty maturity borrowing rates - the following graph shows PWLB certainty maturity rates for a selection of maturity periods throughout the financial year.



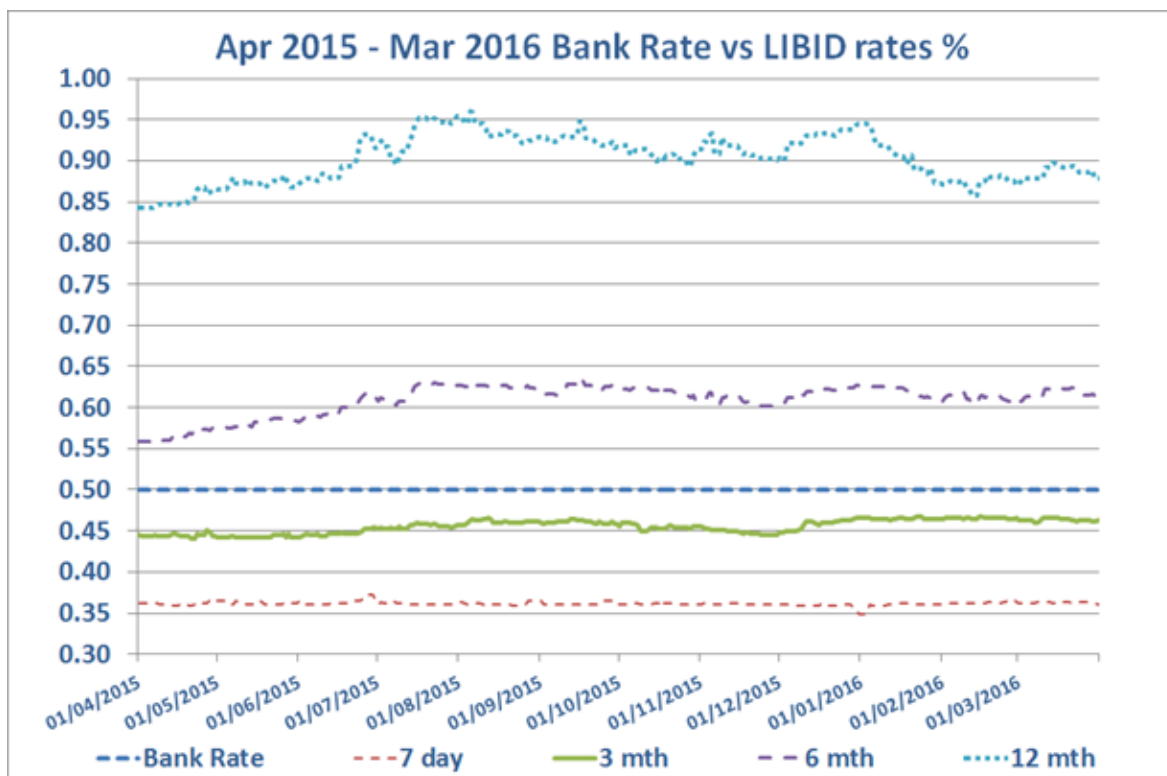
9.0 BORROWING OUTTURN FOR 2015/16

9.1 Due to investment concerns, both counterparty risk and low investment returns, no new borrowing was undertaken during the year.

9.2 The table in paragraph 5.1 provides a summary of borrowing as at 31 March 2016.

10.0 INVESTMENT RATES IN 2015/16

10.1 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.



11.0 INVESTMENTS OUTTURN FOR 2015/16

11.1 Investments Policy – the Council’s investment policy is governed by the Communities and Local Government guidance, which has been implemented in the annual investment strategy approved by the Council on 25 February 2015. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc.).

11.2 The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

11.3 Resources - the Council’s cash balances comprise revenue and capital resources and cash flow monies. The Council’s core cash resources comprised as follows:

Balance Sheet Resources (£'000)	31 March 2015	31 March 2016
Balances	11,023	11,069
Earmarked Reserves	9,474	7,641
Major Repairs Reserve	-	2,609
Capital Grants and Contributions	1,522	1,688
Usable capital receipts	1,907	2,579
Total	23,926	25,586

- 11.4 Investments held by the Council - the Council maintained an average balance of £32.8m of internally managed funds. The internally managed funds earned an average rate of return of 0.71%. The comparable performance indicator is the average 3 Month LIBID rate, which was 0.46%.
- 11.5 Actual investment interest earned during 2015/16 was £223,902 against an original budget of £154,800.
- 12.0 **OPTIONS**
- 12.1 There are no alternative options presented.
- 13.0 **REASONS FOR RECOMMENDATION**
- 13.1 To comply with the Chartered Institute of Public Finance and Accountancy's Code of Practice on Treasury Management 2011.
- 14.0 **EXPECTED BENEFITS**
- 14.1 The report provides Members with a summary of the economy, the effect it has had on financial markets and the treasury activity during 2015/16. The report requires scrutiny prior to submitting to Council for approval.
- 15.0 **IMPLICATIONS**
- 15.1 **Constitution & Legal**
- 15.1.1 This Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2015/16. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities.
- 15.1.2 The Council's financial strategy, capital financing and borrowing all form part of the Policy Framework and are therefore non-executive matters that fall within the remit of the full Council.
- 15.2 **Financial**
- 15.2.1 The report provides details of the treasury activity for the 2015/16 financial year to inform members on performance and to highlight any changes in the year.
- 15.2.2 Total interest received was £234k with £170k to the General fund (£44k above budget) and £64k to the Housing Revenue Account (£36k above budget)
- 15.2.3 Changes to the CFR for the General Fund include a Voluntary Revenue Provision of £1.6m which reduces future years Minimum Revenue Provision costs to nil in line with the MRP policy.
- 15.2.4 Interest rate changes are highlighted in paragraph 10 above and there is potential for further changes being introduced in the near future so this report is being extended to cover the situation that currently exists and introduce interim Treasury Management Policy changes.

15.2.5 The committee is asked to review the attached report to Council in respect of these changes, to the Treasury Management Policy, and agree future scrutiny actions.

15.3 Risk Management

15.3.1 The Council's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities are security first, liquidity second, then return..

16.0 WARDS/COMMUNITIES AFFECTED

16.1 Due to budgetary considerations all wards are affected

17.0 ACRONYMS

- 17.1 CPBS – Compass Point Business Services
- 17.2 CIPFA – Chartered Institute of Public Finance and Accountancy
- 17.3 HRA – Housing Revenue Account
- 17.4 CFR – Capital Financing Requirement
- 17.5 PWLB – Public Works Loan Board
- 17.6 MRP – Minimum Revenue Provision
- 17.7 VRP – Voluntary Revenue Provision
- 17.8 ECB – European Central Bank
- 17.9 GDP – Gross Domestic Product
- 17.10 GF – General Fund

Background papers: - SHDC Treasury Management Strategy Statement 2015/16

Lead Contact Officer

Name and Post: Sean Howsam – Finance Manager Treasury (CPBS)
Telephone Number: 01507 613248
Email: sean.howsam@cpbs.com

Key Decision: No

Exempt Decision: No

This report refers to a Mandatory Service

Appendices attached to this report:

Appendix 1 - 27th July 2016, Council Report on Treasury Management Policy Amendments