

TELFORD & WREKIN COUNCIL

AUDIT COMMITTEE – 28 JUNE 2016

TREASURY MANAGEMENT - 2015/16 ANNUAL REPORT AND 2016/17 UPDATE

REPORT OF THE ASSISTANT DIRECTOR: FINANCE & HR (CHIEF FINANCIAL OFFICER)

PART A) – SUMMARY REPORT

1. SUMMARY OF MAIN PROPOSALS

The report updates members on the outcome of Treasury Management activities for 2015/16 and details the position for 2016/17 to date.

2015/16 Treasury Outturn

The treasury portfolio ended the year with net indebtedness of £156.9m (borrowing: £164.1m less investments: £7.2m (excluding NuPlace Share capital). Base rate was 0.5% for the whole year and is predicted to stay at 0.5% until 2018.

The borrowing strategy for 2015/16 was to borrow temporarily to take advantage of low interest rates where possible and review opportunities for new longer term borrowing as appropriate. Borrowing was £47.5m higher at 31 March 2016 compared to 31 March 2015, however investments were £3.4m higher (excluding NuPlace share capital). The net increase in net indebtedness was due to capital expenditure, including on income generating schemes such as NuPlace and the Property Investment Portfolio as well as the Ironbridge Gorge land stability project and various highways schemes. The value of fixed assets on the balance sheet has increased by £47.9m (prior to new Academies being removed) to £571.7m. Short term borrowing was used during the year at favourable interest rates generating a significant benefit for the Council's budget.

The investment strategy for 2015/16 was to gain maximum benefit with security of capital being the key consideration. The average return on investments for the year was 0.42% against a benchmark of 0.37%.

Overall, treasury delivered a net over-achievement of £7.095m against the budget set for 2015/16. The majority of the saving relates to the benefit of extending the change in the calculation of the Minimum Revenue Provision applied in 2013/14 and 2014/15 to include historic debt (government allocations) and the Private Finance Initiative. It also includes £0.089m generated as a one-off saving in 2015/16 as a result of capitalisation of interest on capital projects pending their completion.

2016/17 Update

The strategy for 2016/17 remains consistent with that of the previous year. Investment opportunities will be reviewed as they arise and we will seek to gain maximum benefit within the agreed risk parameters. There are currently no long term investments, which reduces counter-party risk and also reduces net interest costs as longer-term borrowing costs tend to be greater than we are able to earn on new investments.

Based on the capital programme, borrowing will be required during the year and consideration will be given to the maturity profile of current debt, interest rates and refinancing risks as well as the source, which is primarily expected to be the Public Works Loans Board or potentially forward fixed market fixed-rate loans.

Temporary borrowing was £75.6m at 31/3/16 and has reduced slightly to £71.5m as at 31 May 2016. Investments were £8.5m at 31 May 2016.

2. RECOMMENDATIONS

Audit Committee Members are asked to:-

- 2.1 note the contents of the report
- 2.2 note the performance against Prudential Indicators.

3. SUMMARY IMPACT ASSESSMENT

COMMUNITY IMPACT Do these proposals contribute to specific priority plan objectives?

Yes/~~No~~ Efficient Community Focussed Council

Will the proposals impact on specific groups of people?

~~Yes~~/No

TARGET COMPLETION / DELIVERY DATE Part of ongoing Treasury Management Activities within the Treasury Management Strategy and Policy approved by Council.

FINANCIAL/VALUE FOR MONEY IMPACT Yes/~~No~~ Where appropriate these are detailed in the body of the report.

LEGAL ISSUES Yes/~~No~~ The AD: Finance & HR (Section 151 Officer), has responsibility for the administration of the financial affairs of the Council. In providing this report the Section 151 Officer is meeting one of the responsibilities of the post contained within the Council's Constitution at Part 2, Article 12, paragraph 12.04(f) which states "The Chief financial Officer will contribute to the

promotion and maintenance of high standards of governance, audit, probity and propriety, risk management and the approval of the statement of accounts through provision of support to the Audit Committee.”

**OTHER IMPACTS,
RISKS AND
OPPORTUNITIES**

Yes/No

The key opportunities and risks associated with treasury management activities are set out in the body of the report and in the Treasury Management Strategy and Policy approved by Council and will be regularly monitored throughout the year.

**IMPACT ON
SPECIFIC WARDS**

Yes/No

4. **PREVIOUS MINUTES**

Council 5 March 2015

Audit Committee 30 June 2015

Audit Committee 26 January 2016

Council 3 March 2016

PART B – ADDITIONAL INFORMATION

5. **BACKGROUND**

Treasury Management in local government is regulated by the 2001 revision of the CIPFA Treasury Management in Public Services: Code of Practice (the Code). This Council has adopted the Code and fully complies with its requirements. The primary requirement of the Code is the formulation and agreement by full Council of a Treasury Policy Statement, which states the policies and objectives of its treasury management activities.

A requirement of the Council’s Treasury Management Practices is the reporting to the Council of both the expected treasury activity for the forthcoming financial year (the annual treasury strategy statement) and subsequently the results of the Council’s treasury management activities in that year (this annual treasury report).

6. **2015/16**

The annual report is covered in paragraphs 6-15 and deals with: -

- 2015/16 Portfolio position;
- the borrowing strategy for 2015/16;
- the borrowing outturn for 2015/16;
- compliance with treasury limits;
- investments strategy for 2015/16;
- investments outturn for 2015/16;

- debt rescheduling;
- Shropshire Council debt
- overall outturn position
- leasing

7. **2015/16 PORTFOLIO POSITION**

The Council's treasury management position at the beginning and the end of the year was as follows: -

	31 March 2016		31 March 2015	
	Principal £m	Rate %	Principal £m	Rate %
Borrowing	164.098	2.82	116.613	3.49
Investments (excluding NuPlace share capital)	7.189	0.42	3.778	0.92
Net Indebtedness (ex NuPlace)	<u>(156.909)</u>		<u>(112.835)</u>	
Investment in NuPlace	3.500		0.000	
Net Indebtedness	<u>(153.409)</u>		<u>(112.835)</u>	

There was new temporary borrowing and repayment of £1m PWLB during 2015/16 as well as new PWLB borrowing of £2m; temporary borrowing was £75.6m at 31 March 2016 (including £1m PWLB maturing in 2016/17). The capital programme was funded from a combination of borrowing, capital receipts, grants and other external contributions plus funds from maturing investments; this has resulted in an increase in net indebtedness during the year. Prudential borrowing increased in 2015/16 due to planned capital expenditure approved as part of the capital programme. Investments at 31/3/16 included £3.5m share capital in NuPlace.

The Adopted Treasury Strategy was to:-

- Monitor borrowing opportunities determined by the prevailing markets.
- Only investing short term to meet cashflow requirements.
- Reduce the volatility of investment returns while maintaining adequate flexibility in arrangements.
- To achieve optimum return on investments commensurate with proper levels of security and liquidity.

9. **COUNCILS RESPONSE TO ECONOMIC CLIMATE**

- 9.1 The UK economy slowed in 2015 with GDP growth falling to 2.3% from a robust 3.0% the year before. CPI inflation hovered around 0.0% through 2015 with deflationary spells in April, September and October. The prolonged spell of low inflation was attributed to the continued collapse in the price of oil from \$67 a barrel in May 2015 to just under \$28 a barrel in January 2016, the appreciation of sterling

since 2013 pushing down import prices and weaker than anticipated wage growth resulting in subdued unit labour costs. CPI picked up to 0.3% year/year in February, but this was still well below the Bank of England's 2% inflation target. The labour market continued to improve through 2015 and in Q1 2016, the latest figures (Jan 2016) showing the employment rate at 74.1% (the highest rate since comparable records began in 1971) and the unemployment rate at a 12 year low of 5.1%. Wage growth has however remained modest at around 2.2% excluding bonuses, but after a long period of negative real wage growth (i.e. after inflation) real earnings were positive and growing at their fastest rate in eight years, boosting consumers' spending power.

- 9.2 The Council has continued to maintain short duration and relatively low level of investments during 2015/16. This reduces exposure to investment risk.
- 9.3 We have closely followed investment guidance issued by our Treasury Advisors in relation to credit ratings, financial standing and duration and take advice on borrowing strategies and options.

10. **BORROWING 2015/16**

10.1 **Original Economic Projections**

The Expectation for Interest Rates – When the budget was set for 2015/16 the “average” City view anticipated that Bank Rate would remain at 0.5% until August 2015 before starting to rise gradually back towards more normal levels in 2015, though Bank Rate would take a long time to return to a normalised level of the Bank Rate post-crisis to range between 2.5% and 3.5%.

10.2 **Outturn 2015/16**

During 2015/16 the Monetary Policy Committee (MPC) was focused on helping the economy to recover, but with inflation falling and staying below target level.

The MPC also maintained the level of quantitative easing at £375bn.

The dominant focus in 2015/16 was on low inflation, quarterly GDP growth figures and the unemployment rate. Overall for 2015/16 the economy grew by 2.3%.

Inflation had been a major concern of the MPC but this has been flat for the year commencing at 0.0% in March 2015 to 0.3% in March 2016. Inflation is predicted to increase back to the 2% target level within the 2 year horizon.

Borrowing and Investment Rates in 2015/16

The overnight investment rate has varied little during the year.

Treasury Borrowing and Rescheduling

The borrowing strategy for the current year was to borrow temporarily to take advantage of low interest rates where possible and review opportunities for new longer term borrowing as appropriate.

During the year we borrowed one new PWLB loans for £2.0m at the project rate and we had some maturities totalling £1m.

PWLB Repayments & Discounts

No loans were repaid early or rescheduled during the year.

An analysis of the maturity structure of our debt is shown below. The maturing in less than 1 year includes £1.001m of PWLB loans.

Analysis of Debt Maturity as at 31st March

	2016		2015	
	£'000	%	£'000	%
Maturing in less than 1 year	75,579	29.5	29,093	25.0
Maturing in 1-2 years	1,001	0.8	1,001	0.9
Maturing in 2-5 years	2,503	2.4	3,003	2.6
Maturing in 5-10 years	7	1.2	507	0.4
Maturing in more than 10 years*	<u>85,008</u>	66.1	<u>83,009</u>	71.1
	<u>164,098</u>	100.0	<u>116,613</u>	100.0

* this includes £60m LOBO (Lenders Option Borrowers Option) loans that are potentially callable at certain points before the maturity date. There is therefore the potential that these loans would have to be replaced sooner exposing the council to the prevailing market at that time. To-date, none of our LOBOs have been called before maturity and current expectations are that calls in the foreseeable future are unlikely.

Debt Performance

As highlighted in section 7 the average debt portfolio rate has fallen over the course of the year from 3.49% to 2.82%. This is due to the increase in temporary borrowing being undertaken in 2015/16 at low interest rates as compared to 2014/15.

11. COMPLIANCE WITH TREASURY LIMITS

During the financial year the Council operated within the Treasury Limits and Prudential Indicators set out in the Council's Treasury Policy Statement and annual Treasury Strategy Statement

12. INVESTMENTS 2015/16

12.1 Strategy

Internally Managed Investments - The authority currently manages all of its investments in-house and invests within the institutions complying with its counterparty limits and credit rating requirements. All investments are short term related to cash flows in order to minimise counterparty risk and to minimise overall treasury management costs.

Investment Strategy - The agreed short term investment strategy for 2015/16 was to achieve optimum return on investments commensurate with proper levels of security and liquidity.

12.2 Outturn 2015/16

Detailed below are the results of the investment strategy undertaken by the Council, based on the average investment during the year.

	Average Investment	Rate of Return (gross of fees)	Rate of Return (net of fees)	Benchmark Return *
<u>Internally Managed</u>				
Investments	£20.439m	0.42%	0.42%	0.37%

*overnight rate

No institutions in which investments were made showed any difficulty in repaying investments and interest in full during the year.

13. SHROPSHIRE COUNCIL DEBT

The Council makes an annual contribution (£1.781m in 2015/16) towards County Council costs on pre disaggregation debt (i.e. pre unitary inception) - interest paid averaged 5.38% last year. The rate of interest paid on this is managed by Shropshire and is considerably higher than the rate payable by Telford & Wrekin Council on its borrowing.

14. OVERALL OUTTURN FOR 2015/16

The net overall position is summarised in the table below. The sound overall position has resulted from a mix of cash flow benefits plus pro-active treasury management activities. The budget reflected the position when the budget was set, the underspend has been achieved through active management of debt principal and the low interest rates prevailing for the year. Overall a net saving of £7.1m was made against budget for the year which is summarised below:

Summary of Outturn Position

	Estimate £m	Outturn £m	Variance £m
Interest Received	(0.1)	(0.3)	(0.2)
Principal Repayments	3.8	0.0	(3.8)
MRP saving from change of policy re PFI	0.0	(2.1)	(2.1)
Capitalisation of Interest	(0.0)	(0.1)	(0.1)
Shropshire County Council	1.8	1.8	0.0
Interest Paid	<u>5.0</u>	<u>3.7</u>	<u>(1.3)</u>
Net Position	10.5	3.4	(7.1)

15. LEASING

Each year the Council arranges operating leases for assets such as vehicles, computers and equipment. This helps spread the cost over a number of years in line with the anticipated life of the equipment.

The final drawdown for 2015/16 was completed in March. The drawdown consisted of an operating leases from CHG Meridian totalling £0.049m and funded the purchase of ICT equipment over three years and a finance lease with Specialist Fleet Services totalling £0.204m and funded the purchase of ICT equipment and Ice Resurfacing Equipment at interest rates between 1.0% and 1.5%.

16. **2016/17 UPDATE**

The remainder of this report deals with the current financial year based largely on information to 31 May 2016.

16.1 **Strategy**

The strategy for 2015/16 is to continue to keep investments as short term, where possible, to reduce the need to borrow thus reducing investment exposure and maximising overall returns to the revenue account. We will review investment opportunities if they arise and also review borrowing opportunities as we progress through the year and look to take advantage of the advantageous interest rates if possible. 2016/17 and 2017/18 will see the Council continue to invest in significant regeneration projects including highways and building homes and commercial property for rent as part of the approved Housing Investment Programme

16.2 **Interest Rates**

Base rate began the year at 0.5% and has remained there. The current expectation is that there will be no increase before mid 2018.

16.3 **Prudential Regime**

This Council agreed its required indicators at Council on 3 March 2016. There have been no breaches of the indicators and none have been amended. The Council set itself an Operational limit for external debt of £370m for 2016/17 and an Authorised limit of £392m. Our total borrowing outstanding as at 31/05/16 (including PFI) is £217m which is within both limits.

16.4 **Borrowing**

We have not taken any new long term borrowing in 2016/17 and have had no maturities to-date. In total we have £1m maturing during 2016/17.

16.5 **Internally Managed Investments**

The strategy for the year is to gain maximum benefit at minimum risk whilst achieving as a minimum, the overnight deposit rate. For the period to 31 May 2016 some £318m worth of investments have been made in our overnight call accounts. Rates have ranged from 0.40% to 0.45%. As at 31 May 2016 internal investments stood at £8.49m.

Potentially the Council can place up to £15.0m with any Counterparty. At the end of May the greatest exposure with a single counterparty was £4.5m with Svenska

Handelsbanken (53.0% of the portfolio). It was also our only investment with a non UK sovereign institution. A detailed breakdown is shown in Appendix 2.

16.6 **Non UK Sovereign Counterparty Limits**

At present we have a non UK sovereign counterparty limit set at £15m.

17 **Background Papers**

CIPFA Code of Practice for Treasury Management in Local Authorities; Fund Manager Valuations; Temporary Borrowing records; PWLB records
Investment records

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PRUDENTIAL INDICATORS

PRUDENTIAL INDICATOR	2014/15	2015/16	2015/16
(1). EXTRACT FROM BUDGET AND RENT SETTING REPORT	£m	£m	£m
	Actual Outturn	Original Estimate	Actual Outturn
Capital Expenditure			
TOTAL	115.3	110.4	74.5
Ratio of financing costs to net revenue stream			
General fund	3.85%	4.78%	2.88%
Net borrowing requirement			
brought forward 1 April	125.6	148.4	116.6
carried forward 31 March	116.6	203.9	164.1
in year borrowing requirement	-9.0	+55.4	+47.5
Capital Financing Requirement as at 31 March			
TOTAL	295.5	363.1	335.6
Annual change in Cap. Financing Requirement			
TOTAL	+19.6	+49.6	+40.1
Incremental impact of capital investment decisions	£ p	£ p	£ p
Increase in council tax (band D) per annum (not cumulative)	21.20	22.08	22.08

PRUDENTIAL INDICATOR	2014/15	2015/16	2015/16
(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	£m	£m	£m
	final	original	final
Authorised limit for external debt -			
borrowing	240	327	327
other long term liabilities	64	63	63
TOTAL	304	390	390
Operational boundary for external debt -			
borrowing	223	309	309
other long term liabilities	62	61	61
TOTAL	285	370	370
Upper limit for fixed interest rate exposure			
Net principal re fixed rate borrowing / investments	100	100	100
Upper limit for variable rate exposure			
Net principal re variable rate borrowing / investments:-	80%	30%	30%

Upper limit for total principal sums invested for over 364 days (per maturity date)	95%	95%	95%
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Maturity structure of fixed rate borrowing during 2015/16	lower limit	upper limit
under 12 months	0%	50%
12 months and within 24 months	0%	30%
24 months and within 5 years	0%	50%
5 years and within 10 years	0%	75%
10 years and above	25%	100%

Summary of Investments at 31 May 2016

	Sovereign Credit Rating	Individual credit Rating	Total £m	%
Call Accounts				
Lloyds Svenska	UK AA+	F1+AA- support 5 viability a	3.921	46.4
Handelsbanken	SWE AAA	F1+AA- support 2 viability aa-	4.535	53.6
			8.456	100.0
Fixed Deposits				
			0	
			0.000	0.0
Variable Deposit				
			0	
Total			8.456	100.0
Non UK holding £4.5m (Limit £15m)				