CT/16/60
Corporate Services Scrutiny Committee
27 June 2016

TREASURY MANAGEMENT STEWARDSHIP ANNUAL REPORT 2015/16

Report of the County Treasurer

Please note that the following recommendations are subject to consideration and determination by the Committee before taking effect.

Recommendation: that the Committee notes the report and considers whether it wishes to make any further comments to Cabinet.

1. Introduction

1.1. The County Council has adopted the CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management in the Public Services. A revised Code of Practice was published by CIPFA in November 2011 and a revised Policy Statement and Treasury Management Practices (TMPs) were agreed by Council in February 2012. The Treasury Management and Investment Strategy for 2015/16 was agreed by Council in February 2015 and forms part of the published budget book.

1.2. Revisions to the Treasury Management and Investment Strategy were supported by the Committee and approved by Cabinet in October 2015. As a result:

- Barclays were brought back onto the Council's counterparty list;
- Leeds Building Society and Coventry Building Society were added to the Council's counterparty list;
- The Treasury Management Strategy now permits investment of up to £30 million in the CCLA (Churches, Charities and Local Authorities) Property Fund. An initial smaller investment of £10 million was made on 31st October 2015 in-line with Cabinet approval.

1.3. The Minimum Revenue Provision (MRP) policy on provision for repayment of external debt and internal borrowing was revised following consideration by the Corporate Services Scrutiny Committee in January and approval by Cabinet and the Council in February

1.4. The purpose of this report is to show the outturn position, review performance and inform members of any key matters arising from the Council's Treasury and Debt Management activities during the 2015/16 financial year. The report also includes an update on the 2016/17 Strategy. This report, together with any comments offered by this committee, will be considered by Cabinet on 13th July.

2. Minimum Revenue Provision

2.1. Each year the Council has a statutory obligation to charge to the revenue account an annual amount of Minimum Revenue Provision (MRP), that is a charge to make provision for the repayment of the authority's external debt and internal borrowing. The charge is based on the historic borrowing required to fund the Council's capital programme.

2.2. During the year the MRP policy was reviewed, and the method for calculating the pre-2008 element of the charge was changed from charging 4% per annum on a reducing balance method to basing the charge on the asset life method. This means that the MRP will be charged in equal instalments over the life of the asset benefiting from the capital spend.

This brings the policy for pre-2008 borrowing in line with the policy for post-2008 borrowing. The change was considered by the Corporate Services Scrutiny Committee in January and was agreed by Cabinet and the Council in February.

2.3. As a result of the change in policy the MRP charge for 2015/16 to make provision for the repayment if the Council's external debt and internal borrowing was £11.9 million less than the budget. As anticipated in the Medium Term Financial Strategy this sum has been added to the Budget Management Reserve with the intention that it will be used in 2017/18 to help protect services.

3. Treasury Management Outturn Position 2015/16 - Borrowing

3.1. The overall aims of the borrowing strategy are to achieve:

- Borrowing at the lowest rates possible in the most appropriate periods;
- The minimum borrowing costs and expenses;
- A reduction in the average interest rate of the debt portfolio.

3.2. The Medium Term Financial Strategy assumption was that no new long-term borrowing would be required, although this would be kept under review. This has been made possible by the current capital financing regime, whereby the Government now provides capital grants rather than supported borrowing, and prudent management of the capital programme.

3.3. Active treasury management and the maintenance of levels of liquidity aim to avoid the need for short term borrowing. Cash positions are monitored daily and modelled over a monthly horizon to ensure that anticipated liquidity levels are forecast accurately.

3.4. However, the identification of temporary shortfalls in available cash meant that short-term borrowing was required for brief periods during September and October. Four loans totalling £14.4m were undertaken from other local authorities, each for a 30 day period at an average rate of 0.30%. The total amounts borrowed were not required for the full term of each loan and we were able to invest the surplus funds at a higher rate resulting in a small net gain to the authority. No further short-term borrowing was required during 2015/16.

3.5. In accordance with the Medium Term Financial Strategy, no long term borrowing was undertaken during this financial year. Instead all borrowing required to fund capital expenditure was met from internal cash balances. This position will be kept under review, but the expectation remains that no new external borrowing will be required during the three year period.

3.6. No opportunities arose during the 2015/16 financial year to repay outstanding debt without incurring substantial premium penalties, which would negate any benefit of repaying the debt. The Public Works Loan Board (PWLB) sets premature repayment rates, and where the interest rate payable on a current loan is higher than the repayment rate, the PWLB policy imposes premium penalties for early repayment. With current low rates of interest these penalties would be of a significant cost. Therefore it will only make financial sense to repay debt early if the PWLB changes its current policy, or if interest rates rise and cancel out the repayment premiums.

3.7. At 31st March 2016 the level of long term debt stood at £507.85m as detailed in the table below.

Analysis of Long Term Debt

	Actual 31.03.15 £'m	Interest Rate %	Current 31.03.16 £'m	Interest Rate %
Fixed Rate Debt				
PWLB	436.35	4.99	436.35	4.99
Money Market	71.50	5.83	71.50	5.83
Variable Debt				
PWLB	0.00		0.00	
Money Market	0.00		0.00	
Total External Borrowing	**507.85**	**5.11**	**507.85**	**5.11**

3.8. The long term debt figure presented in the Statement of Accounts for 2015/16 is £511.386m (£3.54m greater than the figure stated above). This difference is due to an accounting standard adjustment which requires us to record the value of our long term debt at its Net Present Value in the Statement of Accounts. The LOBOs (Lender Option Borrower Option) have stepped interest rates and are revalued annually based on the effective interest rate for the duration of the loan. This revaluation has the effect of smoothing the stepping of the interest over the life of the loans.

4. Treasury Management Outturn Position 2015/16 - Investments

4.1. The overall aim of the Council's investment strategy is to:

- Limit the risk to the loss of capital;
- Ensure that funds are always available to meet cash flow requirements;
- Maximise investment returns, consistent with the first two aims;
- Review new investment instruments as they come to the Local Authority market, and to assess whether they could be a useful part of our investment process.

4.2. The investment performance of the County Council’s cash continues to be affected by the low interest rates introduced as part of the measures used to alleviate the global credit crunch. Interest rates have also been impacted by the introduction of banking regulations requiring banks to hold higher levels of liquidity to act as a buffer.

4.3. The rates on offer during 2015/16 and going forward into 2016/17 continue to be low and the returns on the County Council’s cash investments are forecast to remain at the current low levels for the foreseeable future; however, the Treasury Management Strategy will continue to ensure a prudent and secure approach.

4.4. Revenue lending during 2015/16, including the use of term deposits, call accounts and property funds, earned interest of £1.139m against a full year budget of £0.950m. The interest figure quoted is the return from the Council’s Treasury Management activity and is different from the figure presented in the Statement of Accounts which also includes interest generated from a number of other sources.

4.5. The interest earned equated to an investment return of 0.76% against a full year budget target return of 0.65%. This was achieved and interest income was higher than budgeted, partly due to higher levels of cash being invested than anticipated when the budget was set, and also the addition of the CCLA property fund to the approved list of counterparties.

4.6. All lending has been carried out in accordance with the Council's Treasury Management Strategy and with institutions on the list of approved counterparties.

4.7. The following table shows the County Council's fixed and variable rate investments as at the start and close of the financial year:

Schedule of Investments

	Maturing in:	Actual 31.03.15 £'m	Interest Rate %	Current 31.03.16 £'m	Interest Rate %
Bank and Building Society Deposits					
Fixed Rates					
Term Deposits	< 365 days	50.00	0.84	73.80	0.60
	365 days & >	0.00		0.00	
Callable Deposits					
Variable Rate					
Call & Notice Accounts		80.76	0.59	45.00	0.84
Money Market Funds (MMFs)		0.00			
Property Fund		0.00		10.00	4.67
All Investments		**130.76**	**0.69**	**128.80**	**1.00**

4.8. The figure as at 31st March 2016 includes approximately £14.6m related to the Growing Places Fund (GPF). This figure was approximately £15.9m as at 31st March 2015. Devon County Council is the local accountable body for the GPF, which was established by the Department for Communities and Local Government to enable the development of local funds to address infrastructure constraints, promoting economic growth and the delivery of jobs and houses. The Council is working in partnership with the Local Economic Partnership, and interest achieved on the GPF funds, based on the average rate achieved by the Council's investments, will accrue to the GPF and not to the County Council.

5. Prudential Indicators

5.1. Linked to its Treasury Management Strategy, the County Council is required to monitor its overall level of debt in line with the CIPFA Code of Practice. Part of the code requires consideration of a set of Prudential Indicators in order to allow the Council to form a judgement about the affordable, prudent and sustainable level of debt.

5.2. The purpose of the indicators is to demonstrate that:

- Capital expenditure plans are affordable;
- All external borrowing and other long term liabilities are within prudent and sustainable levels;
- Treasury management decisions are taken in accordance with professional good practice.

5.3. Three Prudential Indicators control the overall level of borrowing. They are:

- **The authorised limit** - this represents the limit beyond which any additional borrowing is prohibited until the limit is revised by the County Council. Revision may occur during the year if there are substantial and unforeseen changes in circumstances, for example, a significant delay in achieving forecast capital receipts. In normal circumstances this limit will not require revision until the estimate for 2017/18 is revised as part of the 2017/18 budget setting process.
- **The operational boundary** – this indicator is based on the probable external debt and other long term liabilities during the year. Variations in cash flow may lead to occasional, short term breaches of the Operational Boundary that are acceptable.
- **The upper limit for net debt** - the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the Capital Financing Requirement.

5.4. During the Budget process, the following Borrowing Limits were set for 2015/16:

- Maximum borrowing during the period (Authorised Limit) £807.2m.
- Expected maximum borrowing during the year (Operational Boundary) £782.2m.
- Underlying Borrowing Requirement to Gross Debt - £133.4m under borrowing.
- Maximum amount of fixed interest exposure (as a percentage of total) 100%.
- Maximum amount of variable interest exposure (as a percentage of total) 30%.

5.5. Members are asked to note that during 2015/16 the Council remained within its set Borrowing Limits and complied with the interest rate exposure limits.

6. 2016/17 Update

6.1. The Medium Term Financial Strategy assumes that, over the three year period, no new long-term borrowing will be required. This is still envisaged to be the case, although this will be kept under review.

6.2. The PWLB policy of imposing premium penalties for the early repayment of long term debt means there is little potential to repay further debt during the current financial year.

6.3. Forecasting future interest rates is difficult as the factors affecting interest rate movements are outside of the Council's control. Whilst short term rates are generally linked to the Bank of England's Base Rate, long term rates are determined by other factors, e.g. the market in Gilts. The County Council retains an external advisor, Capita, who forecast future rates several years forward. Similar information is received from a number of other sources.

6.4. The general consensus among market commentators is that any future interest rate rises will be slow and gradual. Capita's view is that the Bank of England is likely to maintain the current 0.5% rate until December 2016 in order to continue to promote growth and employment.

6.5. The UK recovery since mid-2009 has been relatively slow by historical standards, but still faster than most other G7 economies over the period. The Government has 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. This will impose some drag on the UK economy, but the private services sector should be strong enough to offset this in terms of GDP and jobs growth.

6.6. Consumer spending is likely to be the main driver of UK growth this year, helped by continued low energy and food prices. However, the risks to growth are weighted to the downside in the short term due to international risks, particularly in relation to emerging markets, as well as uncertainties relating to the EU referendum. But there are also upside possibilities if the global environment improves and productivity growth rates accelerate in the UK.

6.7. The global outlook remains mixed with a gradual pick-up in the US and the Eurozone, but a slowdown of growth in China, continued recessions in Russia and Brazil, and increased volatility in financial markets.

6.8. As a result of concerns about the Eurozone crisis, the Council have been cautious about using Santander, due to the bank's Spanish parent company, although they have continued to meet the criteria to remain on the counterparty list. The bank has a UK banking licence and is therefore assessed as being a UK bank and a separate entity from the Spanish parent company. During April Santander's credit rating was upgraded by Moody's from A1 to Aa3. This results from an analysis of the bank's balance sheet structure at the end of 2015 and its near term funding plan, which indicates that Santander UK's deposits are likely to face very low loss-given failure. Santander will now therefore be actively considered for term deposits, subject to them offering competitive rates.

6.9. For 2016/17 it has been assumed that the interest rate earned on lending to banks and building societies will be 0.65% p.a. and the yield from investment in the CCLA Property Fund will be 4.5%. The rates offered by the majority of banks have not improved over the last year, but the targets we have set are thought to be achievable.

7. Summary

7.1. No long term borrowing was undertaken during 2015/16. Four short-term loans totalling £14.4m were undertaken from other local authorities, each for a 30 day period at an average rate of 0.30%. It is not envisaged that any new long term borrowing will be required over the next three year period but this will be reviewed annually.

7.2. No opportunities arose during the 2015/16 financial year to repay outstanding debt without incurring substantial premium penalties, which would negate the benefit of repaying the debt.

7.3. Investment income of £1.139m was achieved in 2015/16 against a full year budget of £0.950m. This represented a return of 0.76% against a full year budget target return of 0.65%. Successful prudent management of the Council’s short term cash reserves has delivered a surplus of £0.189m for the 2015/16 financial year.

7.4. As a result of the change in policy the MRP charge for 2015/16 to make provision for the repayment if the Council's external debt and internal borrowing was £11.9 million less than the budget.

Mary Davis

Electoral Divisions: All
Local Government Act 1972
List of Background Papers - Nil
Contact for Enquiries: Mark Gayler / Dan Harris
Tel No: (01392) 383621 Room G97/G99