Report to: Audit & Governance Committee **Date of Meeting:** 21st September 2016

Subject: Treasury and Capital activity – Outturn 2015/16.

Report of: Head of Corporate Resources

Wards Affected: All

Is this a Key Decision? No

Is it included in the Forward Plan? No

Exempt/Confidential No

Purpose/Summary

To inform members of performance against Prudential Indicators, and Treasury Management activities undertaken for 2015/16. The report also includes the Treasury Management position to August 2016.

Recommendation(s)

Audit & Governance is asked to note the contents of this report.

How does the decision contribute to the Council's Corporate Objectives?

	Corporate Objective	Positive Impact	Neutral Impact	Negative Impact
1	Creating a Learning Community		√	
2	Jobs and Prosperity		√	
3	Environmental Sustainability		√	
4	Health and Well-Being		√	
5	Children and Young People		√	
6	Creating Safe Communities		√	
7	Creating Inclusive Communities		√	
8	Improving the Quality of Council Services and Strengthening Local Democracy		√	

Reasons for the Recommendation:
To ensure that Audit & Governance Committee is fully appraised of performance against prudential indicators, and of treasury activity undertaken in 2015/16, and of treasury activity for the period to August 2016.

What will it cost and how will it be financed?

(A) Revenue Costs
The actual investment income to August 2016 is in line with the budgeted amount.

(B) Capital Costs
None.

Implications:
The following implications of this proposal have been considered and where there are specific implications, these are set out below:

Legal	The Council has a statutory duty under the Local Government Act 2003 to review its Prudential Indicators and Treasury Management Activities
Human Resources	None
Equality 1. No Equality Implication √ 2. Equality Implications identified and mitigated ☐ 3. Equality Implication identified and risk remains ☐	

Impact on Service Delivery:
None.

What consultations have taken place on the proposals and when?
The Head of Corporate Resources has been involved in the preparation of this report. (FD 4307/16)

The Head of Regulation and Compliance (LD 3590/15) has been consulted and has no comments on the report.

Are there any other options available for consideration?
None.

Implementation Date for the Decision
Immediately following the Committee Meeting.

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Background Papers:
None.

BACKGROUND:

1. **Introduction**

1.1. The CIPFA Prudential Code for Capital Finance in Local Authorities (The Prudential Code) was introduced following the Local Government Act 2003. The Prudential Code details a number of measures/limits/parameters (Prudential Indicators) that, to comply with legislation, must be set in respect of each financial year to ensure that the Council is acting prudently and that its capital expenditure proposals are affordable. Original Prudential Indicators for 2015/16 were approved on 5th March 2015.

1.2. A requirement of the Prudential Code is the reporting to Audit & Governance Committee of the outturn position of Prudential Indicators following the end of financial year. In accordance with this requirement, this report outlines the 2015/16 outturn for the following Prudential Indicators:-

(i) Capital Expenditure (Sections 2);
(ii) Financing Costs/Net Revenue Stream (Section 3);
(iii) Capital Financing Requirement (Section 4);
(iv) Borrowing Limits (Section 5);
(v) Treasury Management Indicators (Section 6).

1.3. The Treasury Management Policy and Strategy Statements are agreed annually by the Council as part of the budget process. A requirement of the Policy Statement is the reporting to Audit & Governance of the results of the Council's treasury management activities in the previous year. Treasury management in this context is defined as:

'The management of the authority's cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.'

1.4. In accordance with the above this report outlines the results of treasury management activities undertaken in 2015/16 covering the following issues:

- borrowing strategy and practice
- the Council's current Debt Portfolio
- compliance with Treasury Limits
- compliance with Prudential Indicators
- investment strategy and practice.

1.5. The results of treasury management activities in 2015/16 are also reflected in the net expenditure on Capital Financing Costs included within the Council's Revenue Budget.

1.6 The Capital Programme is also agreed annually as part of the budget process. It sets out the anticipated capital expenditure to be incurred within the year.

2. Prudential Indicator 2015/16 – Capital Expenditure

2.1. Prudential indicators are an integral component of measuring how prudently a Council is acting with regard to its finances. They were introduced into all local authorities (by CIPFA) following the Local Government Act 2003. A number of measures/limits/parameters including capital financing, external debt, impact on council tax, and treasury management are set prior to the start of the year and are monitored on a monthly basis.

The original estimate for 2015/16 expenditure together with the actual capital expenditure calculated on an accruals basis for the financial year is as follows:

	£'000
Estimate	21,278
Actual	33,357

2.2 The Capital Programme for 2015/16 shows an increase in expenditure of £12.079m when compared to the original estimate of £21.278m. This movement has been caused by slippage from 2014/15 to 2015/16 and the new starts programme that commenced in 2015/16. The larger schemes that show an increase in expenditure due to slippage or new starts include: Thornton Link Road (£2.24m), Reech Project (£4.139m), Sports Invest to Save schemes (£1.028m) and Disabled Facilities Grant (£2.128m).

2.3 An analysis of spend in the year against the original estimate is at **Annex A**.

3. Prudential Indicator 2015/16 – Financing Costs/Net Revenue Stream

3.1. This indicator measures the financing costs of capital expenditure as a proportion of the net resource expenditure of the General Fund.

3.2. The actual percentage achieved against estimate is as follows:

Estimate	5.9%
Actual	2.2%

3.3 The reduction has been caused by lower than estimated borrowing costs, as a result of a change to the Minimum Revenue Provision (MRP) for Debt Repayment Policy in 2015/16 as agreed by Council on 5th March 2016.

4. Prudential Indicator 2015/16 – Capital Financing Requirement

4.1. The Capital Financing Requirement indicator reflects the Authority's underlying need to borrow for capital purposes. The Council is currently internally borrowed which is a temporary position. This reflects the current national low interest rates for investment of cash balances and the need to find savings for the revenue budget. The decision as to when external borrowing (to finance previous years' capital expenditure) will be undertaken will be kept under review (see also Para. 5.4.3).

4.2. The Capital Financing Requirement is based on historic capital financing decisions and the borrowing requirement arising from the financing of actual capital expenditure incurred in 2015/16. The estimate and the actual Capital Financing Requirement at 31/03/16 are detailed below:

	£'000
Estimate	202,000
Actual	203,178

4.3. The actual level of Total Capital Financing Requirement as at 31st March 2016 is higher than the revised estimate due to the reclassification of the Probation Service debt as part of the changes to the MRP policy.

4.4. CIPFA's Prudential Code for Capital Finance in Local Authorities includes the following statement as a key factor of prudence:

> *"In order to ensure that over the medium term net borrowing will only be for a capital purpose, the local authority should ensure that net external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years".*

4.5. In the report to Cabinet in March 2015, it was stated that the Authority would comply with this requirement in 2015/16. During the financial year, net external borrowing did not exceed the total of the Capital Financing Requirement.

5. Prudential Indicator 2015/16 – Borrowing Limits

5.1. External borrowing undertaken by the Council arises as a consequence of all the financial transactions of the authority, both capital and revenue, and not simply those arising from capital spending. During 2015/16, the Council managed its Treasury position in terms of its external borrowings and investments in accordance with its approved Treasury Management Strategy and established an Operational Boundary and Authorised Limit to manage the level of external debt. These items are described below.

5.2. The Operational Boundary 2015/16

5.2.1. The Operational Boundary sets a limit on the total amount of long term borrowing that the Council can enter into. It reflects the Authority's current commitments, existing capital expenditure plans, and is consistent with its approved Treasury Management Policy Statement and practices.

5.2.2. The estimate and actual outturn for 2015/16 are presented below:

	£'000
Estimate	157,500
Actual	126,828

5.2.3 The actual borrowing is lower that the revised estimate, reflecting the internally borrowed position of the Council, with the projected £4.5m of borrowing budgeted for 2014/15 and £8.5m budgeted for 2015/16 not being taken. The estimate also assumed that £10m of loans repaid in August 2015 would be replaced, however they were not. It should be noted that the estimate also contains borrowing headroom of £5m which was not required during the year.

5.3. The Authorised Limit 2015/16

5.3.1. The Authorised Limit sets a limit on the amount of external borrowing (both short and long term) that the Council enters into. It uses the Operational Boundary as its base but also includes additional headroom to allow, for example, for exceptional cash movements.

5.2.3. The estimate and actual outturn for 2015/16 are presented below:

	£'000
Estimate	172,500
Actual	126,828

The variation reflects the position for the Operational Boundary and the fact that no exceptional cash movements were required.

5.4. Borrowing Strategy and Practice 2015/16

5.4.1 In 2015/16, repayments of £10.174m were made to The Public Works Loan Board (PWLB). Of this £10m was in repayment of the principal element of maturity loans, and £0.174m was in repayment of the principal element of annuity loans.

5.4.2 The Council's external debt activity in the year is summarised in the following table:

	£'000
Opening PWLB Debt 01/04/2015	120,351
Less Repayment Principal Loans	-10,174
Add New Borrowing	0
Closing PWLB Debt 31/03/2016	110,177

5.4.3 It can be noted that the policy of internally borrowing, running down the Authority's cash balances rather than taking out new borrowing or replacing maturing loans, continues. Under present economic conditions, it is considered prudent not to borrow for capital purposes. This provides a financially beneficial position, in revenue terms, for the Council. As the economy improves and interest rates increase, this strategy will need to be reviewed, with external borrowing re-starting as interest rates allow. Our treasury management advisors, SECTOR, will provide support to the Council in determining the most appropriate timing for any new borrowing.

5.5. **Current External Debt Portfolio 2015/16**

The Council's current debt portfolio, taking account of the transactions detailed in paragraph 5.4, can be summarised as follows:

DEBT PORTFOLIO:		
	2014/15	**2015/16**
Average Interest Rate Payable on PWLB Debt in Year	4.44%	4.52%
Debt Outstanding	**31-Mar-15**	**31-Mar-16**
	£'000	**£'000**
PWLB	120,351	110,177
Finance Leases	14,018	12,275
Merseyside Residuary Body	4,813	4,376

5.5.1 The movement in debt reflects the financing decisions taken in paragraph 5.4.3.

5.5.2 The level of the Council's actual external debt has also been monitored throughout the financial year and for information had remained within both of the Prudential Indicators set.

6. **Debt Maturity Profile 2015/16**

6.1 This is a profile measuring the amount of borrowing that is fixed rate maturing in each period as a percentage of total borrowing that is fixed rate.

Fixed Rate Debt Maturity	Upper Limit	Lower Limit	Actual 31/03/2016
Under 12 months	35%	0%	9%
12 months and within 24 months	40%	0%	0%
24 months and within 5 years	40%	0%	0%
5 years and within 10 years	40%	0%	31%
10 years and above	90%	25%	60%

6.2 As can be seen our debt profile highlights that most of our debt is due to mature in 10 years and above, reflecting the internal borrowing position of the Council, as no new borrowing has been undertaken in recent years.

7. Compliance with Treasury Limits 2015/16

7.1 The following Treasury Limits were approved by Council during the 2015/16 Budget Setting process:

Treasury Limits 2015/16	**Limit**	**Actual**
Authorised Borrowing Limit	£172.5m	£126.8m
Short Term Borrowing Limit	£15.0m	£0m
Proportion of variable interest rate External Borrowing	33%	0%

7.2 During the financial year the Council operated within these limits.

8. Interest rate exposure 2015/16

8.1. The following Prudential Indicators were approved for the 2015/16 financial year:

i) **Interest Rate Exposure Indicators**

a) an upper limit of debt outstanding less investments held at fixed interest rates of 340% and a lower limit of 120% of the value of total debt outstanding less total investments;

Actual at 31/03/2016 130% fixed

b) an upper limit of debt outstanding less investments held at variable interest rates of -20% and a lower limit of -240% of the value of total debt outstanding less total investments.

Actual at 31/03/2016 -30% variable

Hence all of the above are within the limit set.

ii) **Non Specified Investment Indicator**

An upper limit on the value of non-specified investments of 40% of total investments. Non specified investments are defined as over 2 years but less than 5 years;

Actual at	**31/03/2016**	11%	CCLA

The Investment is with the Church, Charities and Local Authorities (CCLA) Property Fund. Once again this is within the limit set.

9. Investment Strategy and Practice 2015/16

9.1. The Council invests all available cash balances, which includes school balances and the insurance fund, following a policy of obtaining maximum returns whilst minimising risks.

i) **Externally Managed Investments**
No externally managed funds are held.

ii) **Internally Managed Investments**
The Council's available funds averaged £79.560m and were managed internally with advice from our Treasury Consultants.

In 2015/16 an average return of 0.84% was achieved. This is more than the benchmark 7 day LIBID figure of 0.36% and is considered to be an acceptable return. The majority of the funds are invested with banks and Money Market Funds (MMF's), with £5m is invested with the CCLA Property Fund. The return of 0.84% can be disaggregated into a return of 0.51% on bank and MMF investments, whilst 5.18% was returned by the CCLA investment. The key objective when investing funds is to firstly ensure security, then liquidity, and then yield.

9.2. The level of the Council's investments is summarised in the following table:

Investments	31-Mar-15 £m	31-Mar-16 £m
Total Investment of Cash Balances	54.01	43.52

This year on year reduction is due to the Council's current position of being internally borrowed. £10.174m of PWLB loans were repaid in 2015/16 with no new borrowing undertaken; hence cash balances available for investment were lower when compared to the previous year.

10. **TREASURY POSITION FOR 2016/17 – UPDATE TO 31st AUGUST 2016**

10.1 INVESTMENTS HELD

10.1.1 Investments held at the end of August 2016 comprise the following:

Overnight Deposits

Institution	Deposit £m	Rate %	Maturity	On Current Counterparty List?	Rating
BNP Paribas	5.930	0.41	n/a	Yes	AAA
Federated	5.930	0.42	n/a	Yes	AAA
Insight	5.930	0.37	n/a	Yes	AAA
Invesco	1.580	0.39	n/a	Yes	AAA
Standard Life	5.930	0.43	n/a	Yes	AAA
Total	25.300				

Call Accounts

Bank of Scotland	5.000	0.60	175 day notice	Yes	A+
Santander	2.000	0.90	95 day notice	Yes	A
Santander	2.000	1.05	120 day notice	Yes	A
Total	9.000				

Fixed Term Deposits

Commonwealth Bank of Australia	5.000	0.82	27/01/2017	Yes	AA-
Heleba	5.000	0.84	05/01/2017	Yes	A+
Nationwide	5.000	0.71	05/10/2016	Yes	A
Goldman-Sachs	5.000	0.74	06/12/2016	Yes	A
Total	20.000				

Other

The Funding Circle	0.010	-	n/a	n/a	n/a
CCLA	5.000	5.19	n/a	Yes	n/a
Total	5.010				

10.1.2 All of the investments made since April 2016 have been with organisations on the current counterparty list. The maximum level of investment permitted in the Treasury Management Strategy in any one institution, or banking group, is currently £25m. Whilst the maximum should be retained, in case economic conditions change, a day to day operational maximum of 10% of total investments is currently being imposed. This will spread the risk of investments for the Council, but will have a small detrimental impact on the returns the Council will receive. The Council has remained within that boundary during the year to date. At present, it is not expected that there will be any need to review this limit.

10.1.3 The Council will only invest in institutions that hold a minimum long term Fitch rating of A- for banking institutions, or AAA for MMF's. The ratings applied to investment grade institutions, and the much riskier speculative grade institutions, as defined by Fitch, have been placed into a risk matrix.

10.1.4 The matrix shows how the Council has set its risk appetite by being risk averse and putting security and liquidity before yield:

PROBABLITY of DEFAULT — High

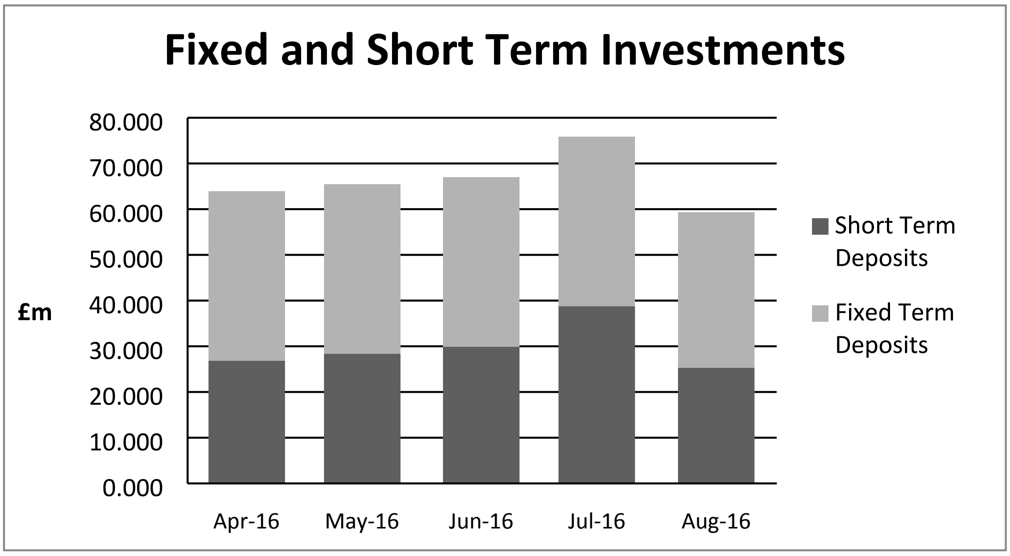
INCREASING YIELD — High

F1 A+ 6	F2 12	F3 18	B 24	C 30	D 36
F1 A+ 5	F2 10	F3 15	F3 20	B 25	C 30
F1+/AA- 4	F1/A 8	F2 12	F3 16	F3 20	B 24
F1+/AA 3	F1/A+ 6	F1/A 9	F2 12	F3 15	F3 18
F1+/AA+ 2	F1+/AA- 4	F1/A+ 6	F1/A 8	F2 10	F2 12
F1+/AAA 1	F1+/AA+ 2	F1+/AA 3	F1+/AA- 4	F1 A+ 5	F1 A+ 6

Low — **High** **SEVERITY of CONSEQUENCE**

		Invested £m
Low	1 - 4	35.300
Low - Medium	5 - 9	19.000
Medium	10 - 20	0.000
High	21 - 36	0.000
n/a		5.010

10.1.5 The ratio of overnight deposits (i.e. short term) to fixed term investments is illustrated below:



10.1.6 The Bank of England Base Rate has dropped to 0.25% from August 2016 and this has had an adverse effect on overall investment yields, particularly in the shorter term. It is anticipated that a further decrease in base rate will occur later in the fourth quarter of 2016. Our Treasury Advisors (SECTOR) have advised looking to longer term investments for better returns.

10.2 INTEREST EARNED

10.2.1 The actual performance of investments against the profiled budget for the period to 31st August 2016 is shown below:

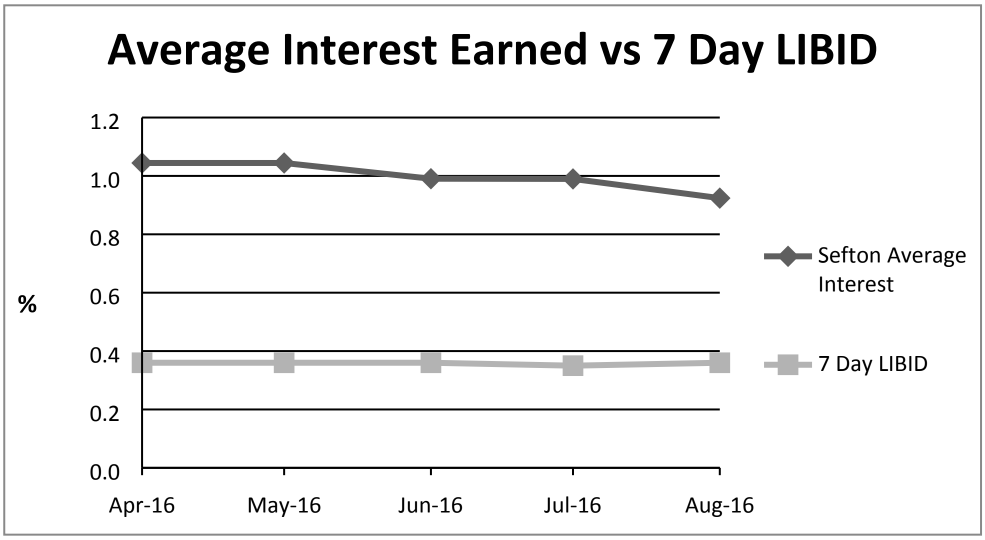
	Budget £'000	Actual £'000	Variance £'000
To Aug 2016	281	280	-1

10.2.2 The budgeted investment average interest rate for 2016/17 is 1.21%, which equates to £0.595m income for the year.

10.2.3 The investment income achieved to 31st August is £0.280m, which equates to an average interest rate of 1%. This is lower than the budgeted average interest rate of 1.2% as the budgeted investment income assumes lower cash balances than actually held. The return of 1% can be disaggregated into a return of 0.63% on bank and MMF investments, whilst 5.2% was returned on the CCLA investment.

As noted in paragraph 10.1.6 it is anticipated that the bank rate will fall again towards the end of 2016 which may decrease returns by the end of the financial year.

We have outperformed the 7 day LIBID average as follows:



10.3 PRUDENTIAL INDICATOR MONITORING 2016/17

10.3.1 As mentioned above, a number of measures/limits/parameters including capital financing, external debt, impact on council tax, and treasury management are set prior to the start of the year and are monitored on a quarterly basis.

10.3.2 Members should be aware that one of the indicators has been breached as at the end of August 2016.

Capital Expenditure is higher than originally estimated due to slippage from 2015/16 schemes.

	£'000
Estimate	20,815
Aug-16	24,857

10.3.3 The breach of this indicator is not considered an issue that needs to be addressed. This position will continue for the remainder of the financial year.

ANNEX A

Committee	Original Estimate	Actual
	£'000	£'000
Schools & Families	3,753	5,993
Locality Services - Commissioned	5,599	13,663
Locality Services - Provision	2,716	257
Older People	951	121
Housing & Regeneration	4,266	10,366
Regulation & Compliance	720	577
Communities	2,399	689
Tourism	50	62
Health & Wellbeing	25	1,131
Corporate Support	799	498
Total Service Based Capital Expenditure	**21,278**	**33,357**