Inverclyde council

AGENDA ITEM NO. 5

Report To:	**Policy & Resources Committee**	**Date:**	**9 August 2016**
Report By:	**Chief Financial Officer**	**Report No:**	**FIN/73/16/AP/KJ**
Contact Officer:	**Alan Puckrin**	**Contact No:**	**01475 712223**
Subject:	**TREASURY MANAGEMENT – ANNUAL REPORT 2015/16**		

1.0 PURPOSE

1.1 The purpose of this report is to advise members of the operation of the treasury function and its activities for 2015/16 as required under the terms of Treasury Management Practice 6 ("TMP6") on "Reporting Requirements and Management Information Arrangements".

2.0 SUMMARY

2.1 As at 31 March 2016 the Council had gross external debt (including PPP) of £280,951,047 and investments of £51,529,212,396. This compares to gross external debt (including PPP) of £284,125,698 and investments of £44,787,396 at 31 March 2015.

2.2 The Council's Capital Financing Requirement at 31 March 2016 was £302,160,000. The gross external debt was £21,208,953 (7.0%) less than the Capital Financing Requirement and so the Council was in an underborrowed position and remains so, having undertaken no borrowing so far in 2016/17. This is attributable to the level of cash backed reserves held by the Council.

2.3 The average rate of return achieved on investments during 2015/16 was 0.864% which exceeds the benchmark return rate for the year of 0.456% by 0.408% and resulted in £209,000 of additional interest on investments for the Council.

2.4 During 2015/16 and in 2016/17 to date the Council did not undertake any debt restructuring and operated within the required treasury limits and Prudential Indicators for the year set out in the Council's Treasury Policy Statement, annual Treasury Strategy Statement, and the Treasury Management Practices.

2.5 Following the result of the EU Referendum that took place on 23 June 2016, there has been volatility in the financial markets and increased economic uncertainty in the UK and around the world with the possibility of a further cut in UK interest rates. The situation is being closely monitored for both risks and opportunities.

3.0 RECOMMENDATIONS

3.1 It is recommended that the Committee notes the contents of the annual report on Treasury Management for 2015/16, the issues in section 5.2 of the report following the result of the EU Referendum, and the ongoing work to seek to ensure the delivery of financial benefits for the Council during the current uncertainty and beyond.

3.2 It is also recommended that the Annual Report be remitted to the Full Council for approval.

Alan Puckrin
Chief Financial Officer

4.0 BACKGROUND

4.1 The Council is required by regulations issued under the Local Government in Scotland Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2015/16.

4.2 Treasury Management in this context is defined as: “The management of the local 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.”

4.3 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).

A glossary of treasury management terms is attached as Appendix 1.

5.0 ANNUAL REVIEW

5.1 The treasury management issues arising during the year were:

a. The Council’s debt (including PPP) has reduced during the year by £3.175m due to repaying maturing debt without undertaking new borrowing. Council investments increased by £6.742m in the year.
b. As at 31 March 2016 the Council had under borrowed against its capital financing requirement by £21.209m. No borrowing has been undertaken during 2016/17 to date.
c. The Council did not undertake any debt restructuring during 2015/16 and remained within its Prudential Indicator and Treasury Management limits during the year.
d. The Bank Rate remained unchanged during 2015/16 at 0.50% (unchanged since March 2009) although the forecast position has changed since the EU Referendum on 23 June 2016 (see below).
e. PWLB rates for new borrowing were expected to increase by between 0.50% and 0.60% during the year. Rates for new borrowing actually fell over the year by up to 0.30% for short-term, remained almost flat for medium term, and fell by up to 0.20% for long-term. These movements were not uniform during the year. Volatility resulted in the difference in rates for some loan periods between their highest and lowest levels being just under 1.00% for some short-term loans and around 0.75% for longer periods.
f. Investment returns were expected to remain relatively low and this was indeed the position during the year.
g. The Council’s investments earned a rate of return of 0.864% during the year and outperformed the benchmark return of 0.456% resulting in additional income to the Council of £209,000.
h. All investments were in accordance with the Council’s investment policy and no institutions with which investments were made had any difficulty in repaying those investments and interest in full during the year.
i. The Council’s investment performance is due to undertaking fixed term and 95/120 day notice account investments at interest rates that were above the benchmark with counterparties which have high creditworthiness (the Bank of Scotland and Santander UK) and in accordance with the Council’s investment strategy.

5.2 The result of the EU Referendum that took place on 23 June 2016 has resulted in increased volatility in the financial markets and economic uncertainty in the UK and around the world. As well as large falls in exchange rates for the £ (which is likely to impact on inflation), PWLB borrowing rates fell to unprecedented levels and the Governor of the Bank of England has indicated the likelihood of further cuts to the UK Bank Rate (at a record low of 0.50% since March 2009) along with increased stimulus to the economy (through Quantitative Easing).

The credit ratings agencies have already changed their view on the UK's credit rating with possible effects on the credit ratings of individual UK banks and financial institutions (and an impact on the Council's options for placing investments with those banks).

Given this uncertainty and the speed with which events are taking place, the situation is being closely monitored for both risks and opportunities.

5.3 The Council's Year End debt position was as follows:

	At 31 March 2015	At 31 March 2016
	£	£
Total Excluding PPP	214,314,698	213,224,047
PPP Debt	69,811,000	67,727,000
Total Including PPP	284,125,698	280,951,047

Further detail is given in the following table:

	At 31 March 2015		At 31 March 2016		Movement 2015/16
	Principal	Rate	Principal	Rate	Principal
	£000		£000		£000
Fixed Rate Funding:					
- PWLB	111,373		110,684		(689)
- Market *	36,000		71,000		35,000
	147,373	3.95%	181,684	4.05%	34,311
Variable Rate Funding:					
- PWLB	0		0		0
- Market *	66,900		31,400		(35,500)
- Temporary	42		140		98
	66,942	4.81%	31,540	4.96%	(35,402)
Total Debt (Excl PPP)	214,315	4.22%	213,224	4.18%	(1,091)
PPP Debt	69,811		67,727		(2,084)
Total Debt (Incl PPP)	284,126		280,951		(3,175)

* - Market Loans are shown as variable when they have less than 1 year to go until their next call date. The total value of Market Loans has reduced by £500,000 during the year due to a loan maturing and being repaid in March 2016.

5.4 The Council's investment position was as follows:

	At 31 March 2015		At 31 March 2016		Movement 2015/16
	Principal	Return	Principal	Return	Principal
	£000		£000		£000
Investments:					
- Fixed Term Deposits	32,500	0.85%	25,500	0.85%	(7,000)
- Notice Accounts (95 Day and 120 Day)	0	0.00%	14,529	0.95%	14,529
- Deposit Accounts	12,287	0.50%	11,500	0.50%	(787)
Totals	44,787	0.76%	51,529	0.80%	6,742

Maximum level of investments in 15/16: £58,646,298 on 15 October 2015
Minimum level of investments in 15/16: £45,010,512 on 22 March 2016
Daily average for the year 15/16: £51,231,358

5.5 <u>2015/16 Outturn Compared to Estimates in 2015/16 Strategy</u>
The 2015/16 outturn compared to the estimates in the 2015/16 strategy:

	2015/16 Estimate	2015/16 Outturn
<u>Borrowing Requirement</u>	£000	£000
New borrowing	0	0
Alternative financing requirements	0	0
Replacement borrowing	0	0
TOTAL	0	0
<u>Prudential/Treasury Management Indicators</u>	£000	£000
Gross external debt including PPP (As at 31 March 2016)	280,864	280,951
Capital financing requirement (As at 31 March 2016)	301,349	302,160
(Under)/over borrowing against CFR	(20,485)	(21,209)
Net external borrowing and capital financing requirement (As at 31 March)	£000 (54,135)	£000 (72,738)
Capital expenditure	£000	£000
• Capital Programme	29,486	30,548
• PPP Schools/Finance Leases (incl. accounting adjustments)	(1,904)	(2,084)
Total	27,582	28,464
Ratio of financing costs (including PPP/ Finance Leases) to net revenue stream	12.87%	12.21%
Incremental impact of capital investment decisions - incremental increase in council tax (band D) per annum (use of capital receipts and prudential borrowing for capital expenditure)	£3.90	£3.25

5.6 <u>2015/16 Outturn Compared to Limits in 2015/16 Strategy</u>

The 2015/16 outturn compared to limits in the 2015/16 strategy:

	2015/16 Limits	2015/16 Outturn
<u>Prudential/Treasury Management Indicators</u> Authorised limit for external debt	£000	£000
• Borrowing	239,000	213,224
• Other long term liabilities	68,000	67,727
	307,000	280,951
Operational boundary for external debt	£000	£000
• Borrowing	255,000	213,224
• Other long term liabilities	72,000	67,727
	327,000	280,951
Upper limit for fixed interest rate exposure (Actual is as at 31 March 2016)	140%	112%
Upper limit for variable rate exposure (Actual is as at 31 March 2016)	40%	-12% *
Upper limit on sums invested for periods longer than 364 days (Actual is maximum in period)	£000 10,000	£000 0
Limits on fixed rate borrowing maturing in each period (LOBOs included based on call dates and not maturity dates) at 31 March 2016		
• Under 12 months	45%	3.0%
• 12 months and within 24 months	45%	28.3%
• 24 months and within 5 years	45%	27.9%
• 5 years and within 10 years	45%	13.9%
• 10 years and within 30 years	45%	4.9%
• 30 years and within 50 years	45%	22.0%
• 50 years and within 70 years	45%	0.0%
<u>Council Policy Limits</u> Maximum Percentage of Debt Repayable In Year (Actual is as at 31 March 2016)	25%	18.8%
Maximum Proportion of Debt At Variable Rates (Actual is as at 31 March 2016)	40%	14.8%
Maximum Percentage of Debt Restructured In Year (Actual is as at 31 March 2016)	30%	0.0%

* - The figure is a minus due to the amount of variable rate investments being greater than the amount of variable rate debt as at 31 March 2016.

The forecast Investment Balances for 2015/16 required under Investment Regulation 31 and the actual position at 31 March 2016 is shown in Appendix 2.

5.7 The forecast from the Treasury Advisers in the Strategy for the Bank Rate as at 31 March and the latest forecast are:

	Forecast Per 2015/16 Strategy	Actual/ Forecast At 4 July 2016	
2015/16	0.50%	0.50%	(Actual)
2016/17	0.75%	0.25%	(Forecast)
2017/18	1.25%	0.25%	(Forecast)

On 30 June 2016 the Governor of the Bank of England made a speech indicating the likelihood of a cut in interest rates with an initial assessment being made on 14 July and a full assessment in the August Inflation Report (due to be published on 4 August). The 4 July forecast above is an initial view from the Council's Treasury Advisers but will be revised in line with the Bank of England timetable.

5.8 The Council's Loans Fund Pool Rate for Interest is used to allocate interest charges to the General Fund and reflects the actual cost of the Council's Treasury activities. The rates for the last 5 years are as follows:

Year	Loans Fund Pool Rate
2011/12	4.208%
2012/13	3.811%
2013/14	3.831%
2014/15	3.934%
2015/16	3.843%

It is expected that there will be a small increase in the Pool Rate in the medium term.

5.9 The Council's investment policy for the year is governed by Scottish Government Investment Regulations and was implemented in the annual investment strategy approved by the Council on 9 April 2015. This policy sets out the approach for choosing investment categories and 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.

All investments in 2015/16 and 2016/17 to date were in accordance with the policy and no institutions with which investments were made had any difficulty in repaying investments and interest in full.

5.10 The result of the investment strategy undertaken by the Council in 2015/16 is as follows:

Average Investment	Rate of Return (gross of fees)	Benchmark Return (3 month LIBID uncompounded)
£51,231,358	0.864%	0.456%

The Council has outperformed the benchmark by 0.408% resulting in additional income to the Council of £209,000. It is expected that investment returns will fall due to likely reductions in investment rates (particularly if the UK Bank Rate is cut).

6.0 IMPLICATIONS

Legal

6.1 None. Any borrowing or lending is done under the Council's legal powers.

Finance

6.2 Through the achievement of exceeding the investment benchmark return rate, the Council has benefited from additional returns of £209,000. The Council utilises Treasury Management as part of the overall Financial Strategy. Officers will continue to investigate borrowing and investment opportunities to bring financial benefits to the Council, all within the Treasury Management Policy.

Human Resources

6.3 None

Equalities

6.4 None

Repopulation

6.5 None

7.0 CONSULTATIONS

7.1 This report has been produced based on advice from the Council's treasury advisers (Capita Treasury Solutions Limited).

8.0 LIST OF BACKGROUND PAPERS

8.1 CIPFA - Treasury Management in the Public Services – Code of Practice and Cross-Sectoral Guidance Notes – 2011 Edition
Inverclyde Council – Treasury Management Strategy 2015/16.

Appendix 1

TREASURY MANAGEMENT
GLOSSARY OF TERMS

Authorised Limit for External Debt
This is a limit for total Council external debt as set by the Council based on debt levels and plans.

Bank of England
The central bank for the UK with ultimate responsibility for setting interest rates (which it does through the Monetary Policy Committee or "MPC").

Bank Rate
The interest rate for the UK as set at regular meetings of the Monetary Policy Committee ("MPC") of the Bank of England. This was previously referred to as the "Base Rate".

Call Date
A date on which a lender for a LOBO loan can seek to apply an amended interest rate to the loan. The term "call date" is also used in relation to some types of investments with a maturity date where the investments can be redeemed on call dates prior to the maturity date.

Capital Expenditure
Expenditure on or for the creation of fixed assets that meets the definition of Capital Expenditure under the accounting rules as set-out in the Code of Practice on Local Authority Accounting in the United Kingdom and for which the Council are able to borrow.

Capital Financing Requirement
The Capital Financing Requirement (sometimes referred to as the "CFR") is a Prudential Indicator that can be derived from the information in the Council's Balance Sheet. It generally represents the underlying need to borrow for capital expenditure (including PPP schemes).

CIPFA
CIPFA is the Chartered Institute of Public Finance and Accountancy who produce guidance, codes of practice, and policy documents for Councils.

Counterparty
Another organisation involved in a deal i.e. if the Council enters a deal with a bank then the bank would be referred to as the "Counterparty".

Credit Ratings
Credit ratings are indicators produced by a ratings provider (such as Fitch, Moody's or Standard & Poor's) that aim to give an opinion on the relative ability of a financial institution to meet its financial commitments. Credit ratings are not guarantees – they are opinions based on investigations and assessments by the ratings providers and they are regularly reviewed and updated. The Council makes use of credit ratings to determine which counterparties are appropriate or suitable for the Council to make deposits with.

The highest credit rating is AAA.

European Central Bank
Sometimes referred to as "the ECB", the European Central Bank is the central bank for the Eurozone and is the equivalent of the Bank of England. The European Central Bank sets interest rates for the Eurozone.

Eurozone
This is the name given to the countries in Europe that have the Euro as their currency. Interest rates in the Eurozone are set by the European Central Bank. The Eurozone is comprised of the following 19 countries: Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia, and Spain.

Federal Reserve
Sometimes referred to as “the Fed”, the Federal Reserve is the central bank for the US and is the equivalent of the Bank of England. The Federal Reserve sets interest rates for the US.

Fixed Term Deposit
A Fixed Term Deposit or Fixed Term Investment is an investment with a named bank or financial institution which matures on a set date and which is repaid with interest on the maturity date. Fixed Term Deposits cannot be traded and cannot be terminated before the maturity date without the payment of a penalty (if at all).

Gilt Yields
A gilt yield is the effective rate of return that someone buying a gilt at the current market price will receive on that gilt. Since the market price of a gilt can vary at any time, the yield will also vary.

Gilts
Gilts are bonds (i.e. debt certificates) that are issued (i.e. sold) by the UK Government. When they issue gilts the Government sets the interest rate that applies to the gilt, sets when they will repay the value of the gilt, and it agrees to make interest payments at regular intervals until the gilt is repaid or redeemed. Gilts are traded in the financial markets with the price varying depending on the interest rate applicable to the gilt, when the gilt will be repaid (i.e. when it will mature), on Bank Rate expectations, and on market conditions.

Gross Domestic Product
Gross Domestic Product (“GDP”) is a measure of the output of goods and services from an economy.

Growth
Positive growth in an economy is an increase in the amount of goods and services produced by that economy over time. Negative growth in an economy is a reduction in the amount of goods and services produced by that economy over time.

IMF
The International Monetary Fund oversees the world financial system and seeks to stabilise international exchange rates, facilitate development, and provide resources to countries in balance of payments difficulties or to assist with poverty reduction.

Incremental Impact of Capital Investment Decisions
These are Prudential Indicators that reflect the impact on Council Tax of movements in projected and estimated capital expenditure within and between financial years.

Inflation
Inflation is the term used for an increase in prices over time. It can be measured in various ways including using the Consumer Prices Index (“CPI”) or the Retail Prices Index (“RPI”).

Investment Regulations
The Local Government in Scotland Act 2003 allows the Scottish Ministers to introduce Regulations to extend and govern the rules under which Scottish Councils may invest funds. The Local Government Investments (Scotland) Regulations 2010 came into effect on 1 April 2010.

LIBID
This is the London Interbank Bid Rate – an interest rate that is used between banks when they wish to attract deposits from each other.

LIBOR
This is the London Interbank Offering Rate – an interest rate that is used as a base for setting interest rates for deals between banks.

LOBO
This is a form of market loan that the Council has with some lenders. The term is short for the phrase “Lender Option/Borrower Option”.

MPC
The MPC or Monetary Policy Committee is a committee of the Bank of England that meets regularly during the year (in meetings over 2 days) to set the Bank Rate for the UK.

Operational Boundary
This is a level of debt set by the Council at lower than the Authorised Limit and which Council debt levels should not normally exceed during normal operations.

Prudential Code
Councils are required to comply with the CIPFA Prudential Code for Capital Finance in Local Authorities. These requirements include the production of Prudential Indicators. The Prudential Code was last revised in November 2011.

Prudential Indicators
Indicators set-out in the Prudential Code that will help Councils to meet requirements in relation to borrowing limits or which will help Councils demonstrate affordability and prudence with regard to their prudential capital expenditure.

PWLB
The Public Works Loan Board is a government agency and part of the Debt Management Office. The PWLB provides loans to local authorities and other specified bodies.

PWLB Certainty Rates
In the Budget in March 2012, the Chancellor of the Exchequer announced that local authorities that provide information on their long-term borrowing and capital spending plans would be eligible for a 0.20% discount rate for new PWLB borrowing. The PWLB Certainty Rates came into effect on 1 November 2012.

PWLB Rates
These are the interest rates chargeable by the Public Works Loan Board for loans. The rates for fixed rate loans are determined by the day on which the loan is agreed. The rates to be charged by the PWLB for loans are set each day based on gilt yields at the start of business each day and then updated at least once during the day.

Quantitative Easing
This is the creation of money by a central bank (such as the Bank of England) in order to purchase assets from banks and companies and boost the supply of money in an economy.

Treasury Management Code
This is the "Treasury Management in the Public Services: Code of Practice" and is a code of practice for Council treasury management activities. It is produced by CIPFA and was last revised in November 2011.

Treasury Management Indicators
These are Prudential Indicators specifically relating to Treasury Management issues.

Treasury Management Practices (TMPs)
This is a Council document that sets out Council policies and procedures for treasury management as required by the Treasury Management Code. The Council also agrees an annual treasury management strategy that is submitted to Committee in accordance with the Treasury Management Practices.

Yield
The yield is the effective rate of return on an investment.

Finance Services
Inverclyde Council
July 2016.

Appendix 2

FORECAST OF INVESTMENT BALANCES
ESTIMATE FOR 2015/16 AND ACTUAL AT 31 MARCH 2016

Investment Regulation 31 requires the Council to provide forecasts for the level of investments. The estimate for 2015/16 and the actual as at 31 March 2016 are:

	2015/16	**2015/16**
	Estimate	**Actual At 31 March 2016**
Cash balances managed in-house		
- At 1 April 2015	50,169	44,787
- At 31 March 2016	33,650	51,529
- Change in year	(16,519)	6,742
- Average daily cash balances	41,910	48,158
Holdings of shares, bonds, units (includes local authority owned company)		
- At 1 April 2015	2	2
- Purchases	0	0
- Sales	0	0
- At 31 March 2016	2	2
Loans to local authority company or other entity to deliver services		
- At 1 April 2015	0	0
- Advances	600	602
- Repayments	10	0
- At 31 March 2016	590	602
Loans made to third parties		
- At 1 April 2015	2,240	2,240
- Advances	1,803	16
- Repayments	33	43
- At 31 March 2016	4,010	2,213
Total of all investments		
- At 1 April 2015	52,411	47,029
- At 31 March 2016	38,252	54,346
- Change in year	(14,159)	7,317