Full Council

8 November 2016

Report of: Anna Klonowski – Interim Strategic Director – Business Change

Title: Treasury Management Annual Report 2015/16

Ward: Citywide

Member presenting report: Councillor Craig Cheney, Cabinet member for Finance, Governance and Performance

Recommendation:

That Council note the Treasury Management Annual Report for 2015/16.

Summary:

Under the CIPFA Code of Practice on Treasury Management (the Code) the Section 151 Officer is required to produce an outturn report on activities in the year to account for how the Strategy set at the start of the year has been implemented. This report meets the requirements of both the Code and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

The significant issues in the report are:

- The Council has complied with treasury management legislative and regulatory requirements during the period and all transactions were in accordance with the approved Treasury Management Strategy.
- No additional long term borrowing was undertaken in the year. The Council's long term debt at 31 March 2016 was £415m (£415m at 31st March 2015) with an average interest rate of 4.81%.
- Investments were £146m at the 31 March 2016 (£191m at 31 March 2015) with an average rate of 0.63% in 2015/16 (0.69% in 2014/15).

The proposal:

Background

1. The Council's treasury management activity is underpinned by CIPFA's Code of Practice on Treasury Management (the Code), which requires local authorities to produce annually Prudential Indicators and a Treasury Management Strategy Statement on the likely financing and investment activity. The Code also requires reports to full Council mid-year and after the year end.

2. The Code also requires the Council to nominate one of its Committees to have responsibility for scrutiny of its treasury management strategy, policy and activity. Council has delegated that responsibility to the Audit Committee. Overall responsibility for treasury management remains with the Council. No treasury management activity is without risk; the effective identification and management of risk are integral to the Council's treasury management objectives.

3. Treasury management is defined as:

   "The management of the local authority's investments and 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."

Economic Background for 2015/16

4. 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; 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.

5. 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.

6. The sharp volatility in equity markets during the year was reflected in sharp volatility in bond yields. However, the overall dominant trend in bond yields since July 2015 has been for yields 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. The ECB commenced a large 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 QE in December 2015.

8. In the US, the economy has continued to grow due to 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.

9. 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 EU. 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.

Treasury position as at 31 March 2016

10. The table below indicates the balance of borrowing (principle only)and investments at the beginning and end of the year:

	31 March 2015		31 March 2016	
	£m	**Rate%**	**£m**	**Rate%**
Long Term Debt (fixed rates) - PWLB	292	5.09	292	5.09
Long Term Debt (fixed rates) – Market	123	4.14	123	4.14
Short Term Borrowing	-	-	2	0.55
Total borrowing	**415**	**4.76**	**417**	**4.81**
Investments	191	0.69	146	0.63
Net Borrowing Position	**224**		**271**	

11. The total borrowing excludes accrued interest of £5m (£5m at 31/3/15), and the outstanding finance on PFI and service contracts leases of £152m at 31 March 2016 (£161m at 31/3/15).

12. During the year the authority borrowed £2m @ 0.55% overnight (31st March 2016) to meet planned financial obligations.

13. The authority also has long term service investments valued at £26m (cost £10m) primarily relating to the equity investment within the Bristol Port and Bristol Holdings Companies. These are not categorised as Treasury Management investments.

Long Term Borrowing – Strategy and outturn

14. The 2015–2018 Treasury Strategy (approved 17th February 2015) identified a medium term borrowing requirement of £150m to support the existing and future Capital Programme with the debt servicing costs predominately met from revenue savings from capital investment. The £150m was planned to be borrowed equally in 2015/16 (£75m) and 2016/17 (£75m).

15. The Council's Strategy is to defer borrowing while it has significant levels of cash balances (£146m at March 2016). Deferring borrowing will reduce the "net" revenue interest cost of the Authority as well as reducing the Councils exposure to counter party risk for its investments. The Council recognises that utilising investments in lieu of

borrowing clearly has a finite duration and that future borrowing may be required to support capital expenditure (see 2015/16 Treasury Management Strategy approved by Council 17th February 2015).

https://democracy.bristol.gov.uk/Data/Full%20Council/201502171400/Agenda/0217_5.pdf

16. Borrowing activity in year was in accordance with the Strategy approved at the beginning of the year:

- **Borrowing** – No new long term borrowing was undertaken in 2015/16, as the authority maintained higher levels of investments than originally anticipated for a variety of reasons including the time taken to progress capital schemes where the source of financing is external borrowing. The authority did borrow £2m @ 0.55% overnight (31st March 2016) to meet planned financial obligations.

- **Rescheduling –** No debt rescheduling activity was undertaken in 2015/16.

- **Repayment –** No debt which matured within the period.

Annual Investment Strategy and Outturn

17. 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 was originally quarter 3 of 2015 but this has since changed to monetary loosening, first reduction expected in quarter 3 2016. Monetary tightening is then expected in quarter 2 2018. Deposit rates remained depressed during the whole of the year.

18. Security of capital remained the Council's main investment objective. This was maintained by following the Council's policy for assessing institutions to which the council might lend. 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.).

19. Investments held by the Council - the Council maintained an average balance of £245m (£248m 2014/15) of internally managed funds. The internally managed funds received an average return of 0.63% (0.69% 2014/15). The comparable performance indicator is the average 7-day LIBID rate, which was 0.36%.

Compliance with Treasury Limits and Treasury Related Prudential Indicators

20. The Council can confirm that:

- All treasury related transactions were undertaken by authorised officers and within the limits and parameters approved by the Council;

- All investments were to counterparties on the approved lending list

- The Council operated within the Prudential Indicators within Appendix 1.

Performance Indicators set for 2015/16

21. One of the key requirements in the Code is the formal introduction of performance measurement relating to investments, debt, and capital financing activities. Whilst investment performance criteria have been well developed and universally accepted, debt performance indicators continue to be a more problematic area with the traditional average portfolio rate of interest acting as the main guide. The Council's performance indicators were set out in the Annual Treasury Management Strategy.

22. The following performance indicators have been set:

- Average rate of borrowing for the year compared to average available - £2m was borrowed overnight (short-term borrowing) at 0.55% compared to average overnight borrowing rates for the year of 0.48%. The margin reflects the timing of borrowing where there is increased demand.
- No long-term borrowing was undertaken in 2015/16. The target rate for the year is 25 year PWLB, the annual average for the year was 3.55%
- Debt – Average rate movement year on year
- Pool rate in 2014/15: 4.81 %
- Pool rate in 2015/16: 4.81%
- Investments – Internal returns above the 7 day LIBID rate
- Average rate for the year 0.63% vs. annual average 7 day LIBID of 0.36%

Consultation and scrutiny input

23. The report does not require any internal consultation to be undertaken. The report has been discussed with the Council's external treasury management advisers.

Risk Assessment

24. The principal risks associated with treasury management are:

- The risk of loss as a result of failure of counterparties

- This is mitigated by limiting the types of investment instruments used, setting lending criteria for counterparties, and limiting the extent of exposure to individual counterparties;

- The risk of loss as a result of borrowing at high rates of interest/lending at low rates of interest

- This is mitigated by planning and undertaking borrowing and lending in the light of assessments of future interest rate movements, and by undertaking most long term borrowing at fixed rates of interest (to reduce the volatility of capital financing costs).

Public sector equality duties:

25. There are no proposals in this report, which require either a statement as to the relevance of public sector equality duties or an Equalities Impact Assessment.

Environmental checklist / eco impact assessment

26. There are no proposals in this report which have environmental impacts

Legal and Resource Implications

27. Legal**-** the Council is under a duty to manage its resources prudently and therefore due consideration must always be given to its borrowing and lending strategy. A wide range of local authority financial activities, including borrowing, lending, financial management, and the approval of types of investment vehicle are governed by legislation and various regulations. The Council is obliged to comply with these.

    Legal advice provided by Shahzia Daya

Financial

(a) Revenue

28. The financing costs arising from planned borrowing are provided for in the revenue budget and medium term financial plan.

    Advice given by Jon Clayton (Principal Accountant)

(b) Capital

29. There is no direct capital investment implications contained within this report.

Land

30. There are no direct implications for this report.

Personnel

31. There are no direct implications for this report.

Appendices:

Appendix 1: Treasury Management Annual Report 2015/16

LOCAL GOVERNMENT (ACCESS TO INFORMATION) ACT 1985

Background Papers:

32. Treasury Management Strategy 2015/16
https://democracy.bristol.gov.uk/Data/Full%20Council/201502171400/Agenda/0217_5.pdf

Appendix 1

Annual Report on the Treasury Management Service 2015/16 (Incorporating Outturn Prudential Indicators)

Introduction

1. This report summarises:

- The capital activity during the year
- What resources the Council applied to pay for this activity;
- The impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement);
- The reporting of the required prudential indicators;
- Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances;
- A summary of interest rate movements in the year;
- The detailed debt activity;
- The detailed investment activity;
- Local Issues

The Council's Capital Expenditure and Financing 2015/16

2. The Council undertakes capital expenditure to invest in the acquisition and enhancement of 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. The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

	2014/15 Actual £m	2015/16 Original Budget £m	2015/16 Final Budget £m	2015/16 Actual £m
Non-HRA capital expenditure	137	158	193	157
HRA capital expenditure	32	52	48	43
Total capital expenditure	**169**	**210**	**241**	**200**
Resourced by:				
Capital receipts	15	10	15	18
Capital grants	71	56	75	76
HRA Self Financing	30	31	37	37
Prudential borrowing	47	97	84	39
Revenue	6	16	30	30
Total Resources	**169**	**210**	**241**	**200**

The Council's Overall Borrowing Need

4. The Council's underlying need to borrow is called the Capital Financing Requirement (CFR). This figure is a gauge of the Council's debt position. It represents 2015/16 and prior years' net capital expenditure that has not yet been paid for by revenue or other resources.

5. Part of the Council's treasury activities is to address this borrowing need, either through borrowing from external bodies, or utilising temporary cash resources within the Council.

6. Reducing the CFR – Whilst under treasury management arrangements actual debt can be borrowed or repaid at any time within the confines of the annual treasury strategy, the Council is required to make an annual revenue charge to reduce the CFR – effectively a repayment of the Non-Housing Revenue Account (HRA) borrowing need. There is no statutory requirement to reduce the HRA CFR.

7. This statutory revenue charge is called the Minimum Revenue Provision - MRP. The total CFR can also be reduced by:

- the application of additional capital resources (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

8. The Council's 2015/16 MRP Policy (as required by CLG Guidance) was approved on 17th February 2015.

9. The Council's CFR for the year is shown below, and represents a key prudential indicator. Accounting rule changes in previous years has meant that PFI schemes are now included on the balance sheet, which increases the Council's borrowing need, the CFR. No borrowing is actually required against these schemes as a borrowing facility is included in the contract.

CFR	General Fund 31 March 2015 Actual £m	General Fund 31 March 2016 Actual £m	HRA 31 March 2015 Actual £m	HRA 31 March 2016 Actual £m	Total CFR 31 March 2016 Actual £m
Opening balance	**439**	**470**	**245**	**245**	**715**
Add unfinanced capital expenditure (as above)	47	39	-	-	39
Less MRP/VRP	(10)	(11)	-	-	(11)
Less PFI & finance lease repayments	(6)	(9)	-	-	(9)
Closing balance	**470**	**489**	**245**	**245**	**734**

Treasury Position at 31 March 2016

10. Whilst the Council's gauge of its underlying need to borrow is the CFR, Finance can manage the Council's actual borrowing position by either:

- Borrowing to the CFR; or
- Choosing to utilise some temporary internal cash flow funds in lieu of borrowing or
- Borrowing for future increases in the CFR (borrowing in advance of need).

11. The figures in this report are based on the principal amounts borrowed and invested and so may differ from those in the final accounts by items such as accrued interest.

	31 March 2015		31 March 2016	
	Principal £m	**Average Rate%**	**Principal £m**	**Average Rate%**
Fixed Interest Rate Debt	415	4.81	417	4.81
Variable Interest Rate Debt	-	-	-	-
PFI & embedded leases	161	-	152	-
Total Debt	**576**	**4.81**	**569**	**4.81**
Debt administered of behalf of Unitary Authorities (Ex Avon Debt)	(50)	-	(48)	-
Revised Debt	526	4.81	521	4.81
Capital Financing Requirement	715		734	
Over/(Under) borrowing	(189)		(213)	
Investment position				
Investments (Fixed & Call)	191	0.69	146	0.63
Net borrowing position (excl leasing arrangements)	**224**	**-**	**271**	**-**

12. The fixed Interest rate debt is apportioned between the General Fund and HRA as set out in the table below.

Fixed Interest Rate Debt	**31 March 2015 £m**		**31 March 2016 £m**	
	Principal £m	**Average Rate%**	**Principal £m**	**Average Rate%**
General Fund	175	4.98	177	4.98
HRA	240	4.69	240	4.69
Total	415	4.81	417	4.81

13. The maturity structure of the debt portfolio (excluding accrued interest) was as follows:

	Approved Min Limit%	**Approved Max Limit%**	**31 March 2015**		**31 March 2016**	
			Actual £m	**%**	**Actual £m**	**%**
Under 12 Months	0	20	-	0.0	2	0.5
1 to 2 years	0	20	-	0.0	-	0.0
2 to 5 years	0	40	3	0.7	3	0.7
5 to 10 years	0	40	15	3.6	20	4.8
10 years and over	25	100	397	95.7	392	94.0
Total			**415**	**100**	**417**	**100**

14. The authority borrowing strategy is to delay borrowing and use its existing resources to support the Capital Programme to reduce its exposure to counterparty risk and the net interest cost of the authority. Therefore the authority has not undertaken any new borrowing during the year.

Prudential Indicators and Compliance Issues

15. Some of the prudential indicators provide either an overview or specific limits on treasury activity. These are shown below:

16. **Net Borrowing and the CFR** - In order to ensure that borrowing levels are prudent over the medium term the Council's external borrowing, net of investments, must only be for a capital purpose. The table below highlights the Council's net borrowing position against the CFR. The Council has complied with this prudential indicator.

	31 March 2015 Actual £m	**31 March 2016 Actual £m**
Net borrowing position	224	271
CFR (excluding PFI)	554	582

17. **The Authorised Limit** - The Authorised Limit is the "Affordable Borrowing Limit" required by S3 of the Local Government Act 2003. Once agreed the authorised limit cannot be breached. The Council does not have the power to borrow above this level. The table below demonstrates that during 2015/16 the Council has maintained gross borrowing within its Authorised Limit.

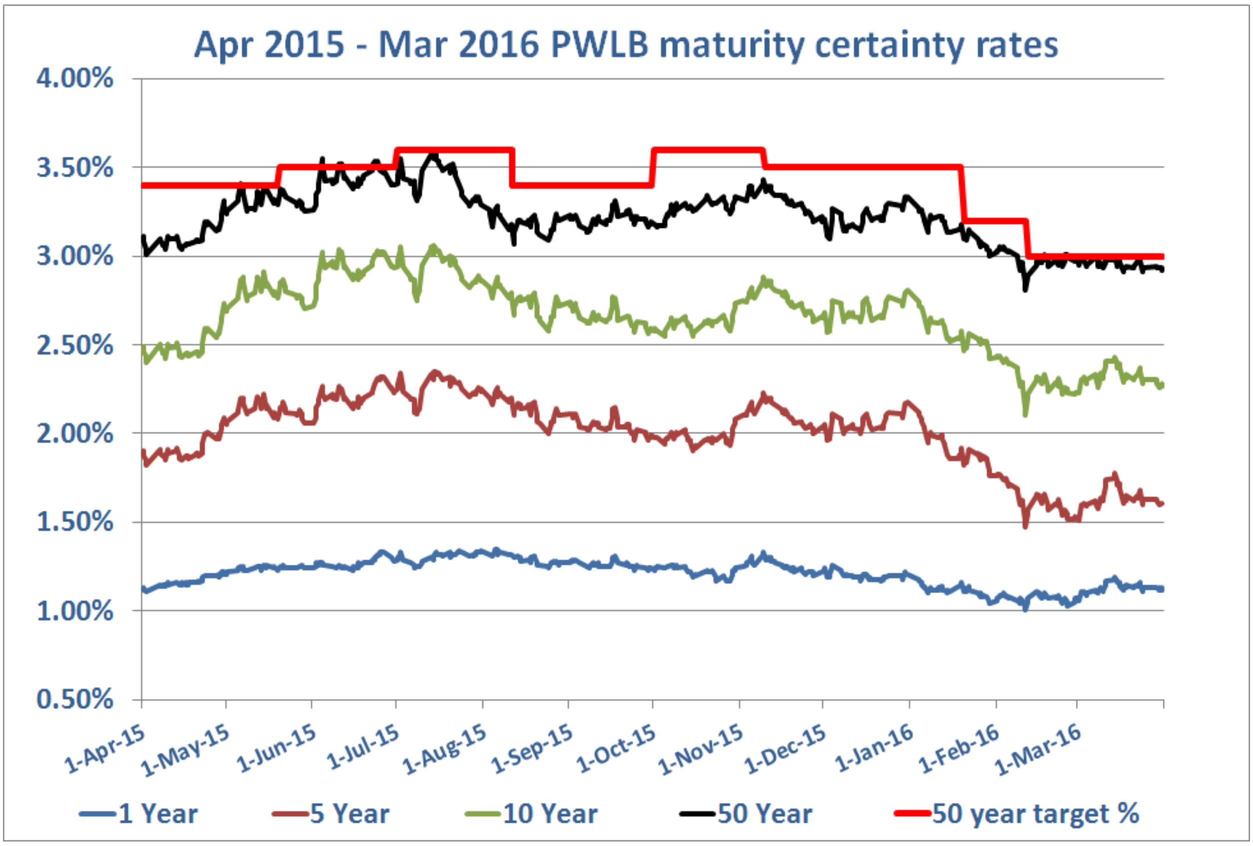
18. **The Operational Boundary** – The Operational Boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the Boundary is acceptable subject to the Authorised Limit not being breached.

19. **Actual financing costs as a proportion of net revenue stream** - This indicator identifies the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

	2015/16 £m
Authorised Limit	810
Operational Boundary	651
Average gross borrowing position (including PFI)	569
Financing costs as a proportion of net revenue stream: General Fund HRA	 8.63% 8.68%

Borrowing Rates in 2015/16

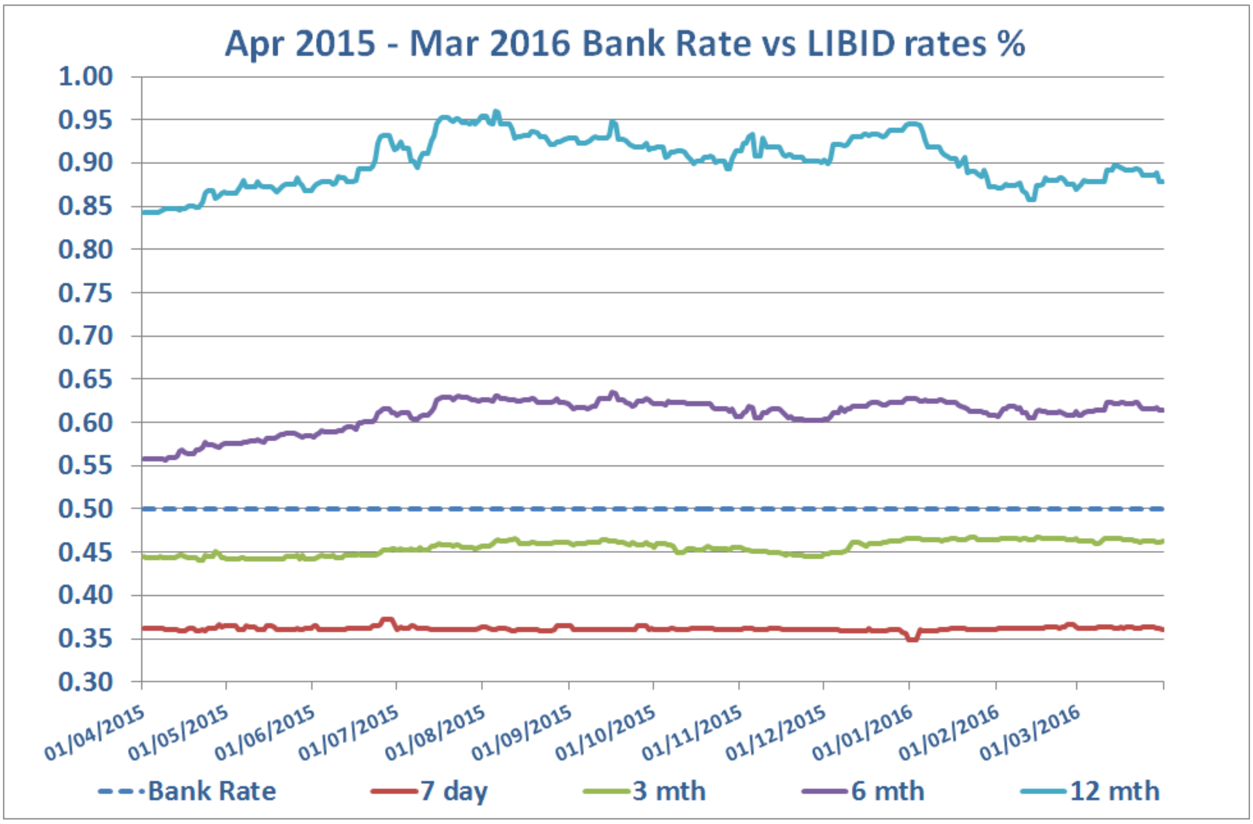
20. PWLB borrowing rates - the graph below shows how PWLB certainty rates have fluctuated throughout the year falling to their historically low levels.



21. **Summary of Debt Transactions –** The overall position of the debt activity remains unchanged as no activity was undertaken during the year. The average rate of interest for long term borrowing is 4.81%.

Investment Rates in 2015/16

22. 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 3 2015 but then moved back to around quarter 1 2016 by the end of the year. Monetary policy has since loosened, first reduction expected in quarter 3 2016, with monetary tightening returning in quarter 2 2018. 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.



23. The Council's investment policy is governed by CLG guidance, which has been implemented in the annual investment strategy approved by the Council on 17th 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.). The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

Local Issues

24. **Ethical Investment Policy-** The Ethical Investment Policy was approved by Cabinet on 15th December 2011. There are no breaches to report.

Regulatory Framework, Risk and Performance

25. The Council's treasury management activities are regulated by a variety of professional codes and statutes and guidance:

    - The Local Government Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;
    - The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions have been made);
    - Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act;
    - The SI requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities;
    - The SI also requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services;
    - Under the Act the CLG has issued Investment Guidance to structure and regulate the Council's investment activities.
    - Under section 238(2) of the Local Government and Public Involvement in Health Act 2007 the Secretary of State has taken powers to issue guidance on accounting practices. Guidance on Minimum Revenue Provision was issued under this section on 8th November 2007.

26. The Council has complied with all of the above relevant statutory and regulatory requirements which require the Council to identify and, where possible, quantify the levels of risk associated with its treasury management activities. In particular its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach.

27. The Council has ensured that the principles of security, liquidity and yield have been adhered to within the treasury operation. This implies that the safeguarding of the principal investment with a suitable counterparty remains the Council's highest priority followed by liquidity (i.e. ease of access to the principal amount deposited) and yield (i.e. return) on investment.