

## Annual Treasury Management Report 2015/16

### 1. Introduction

- 1.1. The council's treasury management activity is underpinned by CIPFA's code of practice on treasury management (the code). Before the start of every year the code requires local authorities to produce prudential indicators and a treasury management strategy statement detailing the policies and objectives of the council's treasury management activities for the forthcoming year. This outturn report compares actual activity to those policies and objectives.
- 1.2. The council borrows and invests substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of these risks are central to the treasury management strategy.

### 2. Economic background

- 2.1. **Growth:** Economic growth (GDP) in 2015/16 fell steadily from an annual rate of 2.9% in quarter one 2015 to 2.1% in quarter four.
- 2.2. **Inflation:** During 2015/16 forecasts for inflation have been repeatedly revised downwards. Annual CPI rose to 0.5% for the year to March 2016, the highest level since December 2014.
- 2.3. **Labour market:** In February 2016 there was an unexpected increase in UK jobless numbers for the three months to February, the rate of unemployment was unchanged at 5.1%. Wages rose at the slowest rate in a year at 1.8%.
- 2.4. **UK monetary policy:** The Bank of England's MPC maintained interest rates at 0.5% during 2015/16. Market expectations for the first increase in bank rate moved considerably during 2015/16 from quarter three in 2015 to quarter two 2018 at the end of the year.
- 2.5. **Market reaction:** 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. The ECB commenced a 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. As for America, the economy has continued to grow healthily, the first increase in the central rate occurred in December 2015.

### 3. Borrowing

- 3.1. The council continues to access lower cost short-term loans from other local authorities rather than more expensive longer term debt due to the differential between short and longer-term interest rates. This policy is expected to continue until 2018 but should this differential decrease and short term borrowing costs increase, the council will begin using more fixed long term debt to fund its borrowing requirements.
- 3.2. In 2015/16 the weighted average interest rate paid on council borrowing was 3.42% (3.43% in 2014/15). The weighted average cost of long term borrowing was 4.14% compared to 0.56% for short-term borrowing (being the gross cost including brokers' commission of between 0.01% and 0.10%). This demonstrates that if the council had secured fixed term borrowing instead of short term the additional fixed term borrowing could have totalled £27.5m which could have been at an additional annual interest cost of £1.0m.

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3.3. It is council strategy to maintain borrowing and investments below their underlying levels by using “internal borrowing”, utilising usable reserves. This maintains borrowing and investment balances to a minimum.

3.4. The actual movement in gilt yields meant that the trend in the public works loan board (PWLB) rates during 2015/16 saw an increase in rates during the first quarter followed by sharp volatility since July 2015 but with an overall trend for rates to fall to historically low levels by the end of the year. This enabled the council to replace some short-term loans with longer-term finance. In 2015/16 the following longer term loan was taken out from the PWLB:

Amount Borrowed	From	To	Period	Type of loan*	Interest Rate
£13m	17/02/16	17/02/28	12 years	EIP	1.64%
*EIP = Equal Instalments of Principal, where loan is repaid in equal instalments every six months over the period of the loan.					

3.5. The premium charged by the PWLB for the early repayment of PWLB debt remained too expensive for existing loans in the council’s portfolio to be repaid and rescheduled. No rescheduling activity was undertaken in 2015/16 and this will continue to be constantly considered.

3.6. Borrowing activity during the year is summarised below:

Borrowing activity in 2015/16	01/04/15 balance £m	New borrowing £m	Debt maturing £m	31/03/16 balance £m
Short-term borrowing	19.0	141.0	(113.5)	46.5
Long-term borrowing	145.5	13.0	(8.6)	150.0
<b>TOTAL BORROWING</b>	<b>164.5</b>	<b>154.0</b>	<b>(122.1)</b>	<b>196.5</b>
Other long-term liabilities*	26.6	0.3	(1.3)	25.6
<b>TOTAL EXTERNAL DEBT</b>	<b>191.1</b>	<b>154.3</b>	<b>(123.4)</b>	<b>222.1</b>
<i>*Other long term liabilities represent existing commitments under PFI arrangements included in the medium term financial strategy</i>				

3.7. Total borrowing increased by £31.9m representing capital spend financed by borrowing, which included the following:

- Energy from waste plant loan, £17.4m, to be funded by future loan repayments
- Road investment of £5.2m, the cost of borrowing to be financed by revenue maintenance cost savings
- LED street lighting investment of £4.0m, to be financed by energy cost savings
- Investment in leisure centres of £2.8m, to be financed by rental charges
- Purchase of three elms trading estate, £1.8m, to be funded by rental income

3.8. The council’s underlying need to borrow is measured by the capital financing requirement (CFR). As at 31/03/2016 this totalled £264.8m. The difference of £42.7m between the CFR and total external debt represents internal borrowing from usable reserves and working capital.

3.9. The council’s capital financing costs in 2015/16 were as follows.

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<b>Capital financing costs for 2015/16:</b>	<b>Budget</b>	<b>Outturn</b>	<b>Over / (under) spend</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>
Minimum Revenue Provision (provision for repayment of loan principal)	9.8	10.4	0.6
Interest on existing longer-term PWLB and bank loans	5.8	5.7	(0.1)
Interest on short-term variable rate loans	0.9	0.2	(0.7)
Less capitalised interest	(0.3)	(0.0)	0.3
<b>Total</b>	<b>16.2</b>	<b>16.3</b>	<b>0.1</b>

3.10. The variances to budget have arisen from:

- An additional voluntary minimum revenue provision contribution to repay debt balances early, saving on future interest costs;
- Short-term variable interest rates being lower than expected resulting in an interest cost saving;
- Less revenue interest costs being capitalised due to less capital scheme spend being funded by borrowing.

#### 4. Investments

4.1. The council invests significant funds, representing income received in advance of expenditure plus balances and reserves. During 2015/16 the council's investment balances averaged at £16m and ranged from £36m in July 2015 to £7.6m in March 2016.

4.2. Security of capital remained the council's primary objective. Investment income remained low due to the continued low interest rate environment and the reduction in investment maturity limits in the treasury management policy which are set for each financial institution following advice from the council's treasury adviser, Capita asset services.

4.3. Investments held at the start and end of the year were as follows:

<b>Investments</b>	<b>01/04/15 balance £m</b>	<b>Investments made £m</b>	<b>Maturities/ withdrawals £m</b>	<b>31/03/16 balance £m</b>
Instant Access Accounts	2.6	349.0	(346.5)	5.1
Notice Accounts	0.2	2.3	-	2.5
Term Deposits	-	2.5	(2.5)	-
<b>Total</b>	<b>2.8</b>	<b>353.8</b>	<b>(349.0)</b>	<b>7.6</b>
<b>Increase in investments</b>				<b>4.8</b>

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4.4. Interest received during the year was as follows:

Month	Average amount invested		Average rate of interest earned		Budget £000	Interest earned £000	(Surplus) /deficit £000
	Actual £m	Budget £m	Actual %	Budget %			
Apr-15	19.5	30	0.52	0.40	10	8	2
May-15	16.9	30	0.59	0.40	10	8	2
Jun-15	16.1	30	0.58	0.40	10	8	2
Jul-15	22.7	30	0.54	0.40	10	10	-
Aug-15	15.5	30	0.60	0.40	10	8	2
Sep-15	12.5	30	0.63	0.40	10	6	4
Oct-15	13.8	30	0.60	0.40	10	7	3
Nov-15	12.5	30	0.60	0.40	10	6	4
Dec-15	15.7	30	0.56	0.40	10	7	3
Jan-16	15.9	30	0.58	0.40	10	8	2
Feb-16	16.6	30	0.58	0.40	10	7	3
Mar-16	10.4	15	0.65	0.40	5	6	(1)
<b>Outturn</b>					<b>115</b>	<b>89</b>	<b>26</b>

4.5. The interest received in the year was below budget due to lower balances being maintained, reducing the need to borrow.

4.6. The average interest rate achieved during 2015/16 was 0.59%, higher than budgeted. This compares favourably with the generally accepted benchmark of the average 7-day London Inter-Bank Bid (LIBID) rate of 0.36%.

4.7. During the year the provision of loan finance to the waste disposal PFI provider generated loan interest payable to us of £0.8m which will be recharged through the PFI.

### 5. Compliance with prudential indicators

5.1. The Council complied with its prudential indicators, treasury management policy statement and treasury management practices for 2015/16, approved 6 February 2015, see Annex 1. A prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.

## Performance Indicators

### 1. Treasury management indicators

The council measures and manages its exposures to treasury management risks using the following indicators.

#### 1.1 Interest rate exposures

This indicator is set to control the council's exposure to interest rate risk. The indicator sets upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of net principal borrowed.

	2015/16 approved limit	2015/16 maximum exposure
<b>Upper limit for fixed rate exposure</b>	100%	100%
<b>Upper limit for variable rate exposure</b>	50%	22%

The above indicator relates to net debt, if the council has variable rate investments at the same level as its variable rate debt it is deemed to have no variable rate exposure (all council investments are regarded as being at variable rate because no investments are for more than one year). For 26 days in the year the council's investments exceeded its variable rate short-term borrowing.

#### 1.2 Maturity structure of fixed rate borrowing

This indicator is to limit large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates.

Maturity structure of fixed rate borrowing	Lower Limit %	Upper Limit %	Actual Fixed Rate Borrowing 31/03/16 £m	% Fixed Rate Borrowing 31/03/16
Under 12 months	0%	20%	8.5	5%
12 months and within 24 months	0%	20%	5.5	4%
24 months and within 5 years	0%	20%	16.2	11%
5 years and within 10 years	0%	20%	24.1	16%
10 years and within 20 years	0%	40%	34.5	23%
20 years and within 30 years	0%	40%	11.9	8%
30 years and within 40 years	0%	40%	21.3	14%
40 years and within 50 years	0%	40%	28.0	19%
<b>Total</b>			<b>150.0</b>	<b>100%</b>

Two LOBO ("Lenders Option then Borrowers Option") bank loans of £6m each are repayable in 2054 however if the lenders seek to increase the interest rate charged, currently 4.5%, the council has the opportunity to repay the loans.

#### 1.3 Upper limit for total principal sums invested over 364 days

The purpose of this limit is to contain exposure to the possibility of financial loss that may arise as a result of the council having to seek early repayment of the sums invested.

Upper limit for total principal sums invested over 364 days	2015/16 Approved £m	2015/16 Actual £m	2016/17 Estimate £m	2017/18 Estimate £m
<b>Total</b>	<b>5</b>	<b>0</b>	<b>5</b>	<b>5</b>

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During 2015/16 no long-term investments were made for a period exceeding 364 days.

### 2. Prudential Indicators

#### 2.1 Estimates of capital expenditure

This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits and, in particular, to consider the impact on council tax.

Capital Expenditure	2015/16		31/03/17 Estimate £000	31/03/18 Estimate £000
	Estimate £000	Actual £000		
<b>Total</b>	<b>77,089</b>	<b>77,047</b>	<b>75,075</b>	<b>50,701</b>

Capital expenditure has been and is expected to be financed or funded as follows:

Capital Financing	2015/16		31/03/17 Estimate £000	31/03/18 Estimate £000
	Estimate £000	Actual £000		
Capital grants	30,267	39,148	24,343	35,873
Capital receipts	5,763	5,691	7,900	6,400
Revenue funding	250	350	0	0
Salix loan	-	-	300	
Prudential borrowing	40,809	31,858	42,532	8,428
<b>Total</b>	<b>77,089</b>	<b>77,047</b>	<b>75,075</b>	<b>50,701</b>

Generally prudential borrowing finance is provided where the return on the investment exceeds the debt financing cost.

### 3. Capital Financing Requirement (CFR)

Estimates of the council's cumulative maximum external borrowing requirement for 2015/16 to 2017/18 are shown in the table below:

Capital Financing Requirement	31/03/16 Approved £000	31/03/16 Actual £000	31/03/17 Estimate £000	31/03/18 Estimate £000
Total CFR	285,109	264,838	316,677	310,744

Total debt is expected to remain at or below the CFR during the forecast period.

### 4. Authorised limit and operational boundary for external debt

The Local Government Act 2003 requires the Council to set an affordable borrowing limit or authorised limit. This is a statutory limit which should not be breached.

The operational boundary is based on the same estimates as the authorised limit but reflects the most likely, prudent but not worst case scenario without the additional headroom included within the authorised limit.

The Section 151 officer confirms that there were no breaches to the authorised limit and the operational boundary during the year; borrowing at its peak was £201.5m.

	2015/16 approved operational boundary £m	2015/16 approved authorised limit £m	Actual external debt as at 31/03/16 £m
Borrowing	270.0	280.0	196.5
Other long-term liabilities	30.0	40.0	25.6
<b>Total</b>	<b>300.0</b>	<b>320.0</b>	<b>222.1</b>

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### 5. Ratio of financing costs to net revenue stream

This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

<b>Ratio of financing costs to net revenue stream</b>	<b>2015/16 Approved %</b>	<b>2015/16 Actual %</b>	<b>2016/17 Estimate %</b>	<b>2017/18 Estimate %</b>
Net revenue stream	141,318	141,993	<b>147,979</b>	<b>142,925</b>
Financing costs	18,502	16,272	<b>16,607</b>	<b>15,622</b>
<b>Percentage</b>	<b>13.1%</b>	<b>11.4%</b>	<b>11.2%</b>	<b>10.9%</b>

### 6. Adoption of the CIPFA Treasury Management Code

This indicator demonstrates that the council has adopted the principles of best practice.

The council has incorporated the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition* into its treasury policies, procedures and practices.