Report

Council

Part 1

Date: July 2016

Item No:

Subject	**Report on Treasury Management covering the Financial Year 2015/16**
Purpose	To inform Cabinet of treasury activities undertaken during the financial year 2015/16.
Author	Assistant Head of Finance
Ward	General

Summary

During the year to 31 March 2016, the Council continued to invest surplus funds with its own bankers (Santander), and institutions with long-term credit ratings in at least the 'A-' Category.

As at 31 March 2016, the Council has short-term investments of £3.10m, and over the financial year, the Council has been both a short term investor and borrower across most months, as expected.

All longer term borrowing undertaken was as expected, and within the Council's agreed limits.

The cabinet considered this report on Mon 6th June 2016 and recommended its adoption by Council

Proposal

Council is asked to:

1. **note the Annual Report on Treasury Management for the Financial Year 2015/16.**

2. **note that 2015/16 Prudential Indicators for Treasury Management were in line with those initially set.**

Action by Head of Finance

Timetable For the periods indicated.

This report was prepared after consultation with:

- Treasury Advisors
- Head of Finance

Signed

Background

1. The Authority's treasury management activity is underpinned by CIPFA's Code of Practice on Treasury Management ("the Code"), which requires authorities to produce annually Prudential Indicators and a Treasury Management Strategy Statement on the likely financing and investment activity. The Code also recommends that members are informed of treasury management activities at least twice a year.

2. This report fulfils the Authority's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the Welsh Government's Investment Guidance.

3. The Authority has a large loan portfolio and also invests surplus cash in the short – term 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 risk are therefore central to the Authority's treasury management strategy.

4. The 2015/16 Treasury Management Strategy was approved by the Council as part of the overall Medium Term Financial Plan and 2015/16 budget in February 2015.

5. This report presents the following information.

    - details of capital financing, borrowing, debt rescheduling and investment transactions
    - reports on the risk implications of treasury decisions and transactions
    - details the outturn position on treasury management transactions in 2015/16
    - confirms compliance with treasury limits and Prudential code

Annual Review Report 2015/16

Short and Long Term Borrowing

6. In recent years the Council's strategy has been to fund capital expenditure from reducing investments rather than undertaking more expensive new long term borrowing. This is because the rates achievable on the Council's investments are lower than the rates that would be payable on long term borrowing. By using this strategy the Council can also minimise cash holding at a time when counterparty risk remains high. The Councils short term cash requirements are dealt with by short term loans when required. In any month, the Council is both a short-term investor and short-term borrower as it maintains low cash holdings, whilst holding off the need for long-term borrowing.

7. Whilst the strategy minimises investment counterparty risk, the risk of interest rate exposure is increased as the current low longer term borrowing rates may rise in the future. The market position is being constantly monitored in order to minimise this risk.

8. As anticipated, the Council has had to undertake short-term borrowing in order to cover normal day to day cash flow activity. Total temporary borrowing of £151.1million was raised during the year, of which with the exception of borrowing related to the Friar's Walk development, , nil remained outstanding at the 31 March 2016.

9. In April 2015 the Council undertook a re-scheduling of a number of debts relating to PWLB. A total of £16.3million debt with an average interest rate of 9.4% was re-paid early. As is normal in these circumstances in the current lower interest rate environment, a premium was payable on redemption, and new long-term loans at a much improved average interest rate of 2.19% were taken out. This allowed the authority to make significant annual savings on the interest payable on these loans, even with the premium, and was part of the approved 2015/16 budget savings.

10. As anticipated during 2015/16 the Council has also been required to undertake additional borrowing of £33million associated with the Friar's Walk development funding and the approved loan to Queensberry Real Estates (Newport) Ltd (QRE) for this. The

borrowing associated with this loan is kept separate from the Council's other borrowing requirements as shown in Table 1. The loan is anticipated to be paid off via capital receipts in 2016/17, and therefore the Council is not required to make MRP charges to the revenue budget in relation to the Friars Walk Development loan as the borrowing will be paid off in full at the end of the scheme within agreed timescales.

11. In addition to re-scheduling of debts and the Queensberry loans discussed above, one further long term loan for £1.4million was taken out from the PWLB during 2015-16 in relation to 21C school's programme where the Council took advantage of attractive preferential loans for this purpose. A total of £187.4 million of long-term loans were outstanding as at 31 March 2016.

12. Total borrowing has remained within the approved limits for external debt as shown in Appendix C and Table 1 to this report compares borrowings and investments as at 31 March 2015 and 2016, showing an increase to net borrowing of £27.96million.

13. Appendix A summarises the loan debt activity for 2015/16. The key points to note are:

    - the average rate of interest on debt was 4.41% compared with 6.03% for the previous year.
    - Long-term loan repayments in 2015/16 totalled £2.910 million.

14. The value of the Council's LOBO money market loans remains the same. No loans were called during the period. Of the £35m outstanding, £25m is subject to potential change of interest rates by the lender (which would automatically trigger a right to the Council to repay these loans) prior to the end of this financial year. Should a change of interest rate be requested, then it will be considered in detail and a decision on how we proceed will be made in conjunction with our treasury advisors.

Investments

15. As per the agreed strategy, the Council is a short-term investor and by 31 March 2016 these valued £3.10million due to funds received by the Council which were invested on overnight terms.

16. Interest rates remained at a historically low level of 0.5% throughout the year. Within this economic environment, the Councils approved Treasury Strategy was to reduce investments held, rather than increase borrowing. This strategy was driven by the gap between investment rates of below 0.50% and borrowing rates of around 2%-4%.

17. The average interest rate achieved on the Council's short-term investments was 0.47%, Whilst this return is below base rate of 0.50%, the following issues account for this:

    - the restricted number of institutions that the Council could lend to; the prime focus being security of funds
    - there are no call accounts with institutions on the approved lending list which pay base rate or above.
    - Investments are too short term to use financial instruments that attract higher rates of return.

18. The Council held no long-term (more than 364 days) investments at 31st March 2016.

19. Security of capital remained the Council's main investment objective. This was maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2015/16. Investments during the year included:

    - Deposits with the Debt Management Office
    - Deposits with other public institutions such as local authorities, police and fire authorities
    - Call accounts and deposits with banks and a single building society all considered systemically important to the UK banking system

Credit Risk

20. Counterparty credit quality was assessed and monitored with reference to credit ratings (the Authority's minimum long-term counterparty rating is [A-] across rating agencies Fitch, S&P and Moody's); for financial institutions analysis of funding structure and susceptibility to bail-in, credit default swap prices, financial statements, information on potential government support and reports in the quality financial press.

21. All of these factors were continually assessed and changes were made as needed to the Council's approved lending list by either suspending any institutions affected temporarily or permanently and/or by varying the amount and time limits for lending.

Future Council borrowing requirements

22. Local Authorities measure their underlying need for long-term borrowing through their 'Capital Financing Requirement' (CFR). This takes into account the amount of planned capital expenditure that needs to be funded through borrowing, (as opposed to external funding - from cash grants, capital receipts or S106 contributions for example) irrespective of whether the borrowing itself is undertaken externally or through dis-investing. Due to the expected repayment of the Queensberry loan in 2016/17, it is likely that the Council will have relatively significant funds to invest over the short - term during 2016/17.

23. Table 2 shows the current and projected CFR for the Council which is reviewed and updated on an on-going basis. As the Council and Cabinet are advised, there is a 'need to borrow' as shown by the CFR over the long-term, but this inherent 'need to borrow' has reduced significantly since previous years. This is due to the fact that we have undertaken borrowing which was anticipated in previous borrowing requirement projections, and the projected CFR has stayed relatively steady due to slippage and additional capital expenditure being offset by a prudent Minimum Revenue Provision Policy, or use of other funding. The Capital Financing Requirement is predicted to be £239.5million by the end of 2016/17, whereas existing long term borrowing is £246.6million. After taking account of cash backed reserves the Authority is unlikely to require additional long-term borrowing during 2016/17 and is likely to be an investor during this period. In saying that, we continue to review the market and our position, with our advisers, to identify if and when it might be useful to take out further longer term loans in the current low interest environment.

Table 1- Treasury Portfolio 2015-2016

31/03/2015 £m		31/03/2016 £m
	External Borrowing:	
(70.13)	Public Work Loan Board	(72.44)
(35.00)	Market Loans (Loans held with various Financial Organisations. Maturity dates range from 2042 – 2078)	(35.00)
(40.00)	Newport City Stock Issue (Bonds paying interest at 8.8% with a maturity date of 2019)	(40.00)
(10.00)	Temporary Borrowing	(0)
(34.97)	Queensberry Borrowing	(72.97)
(0.30)	Other Loans (IFRS)	(0.14)
(190.40)	**Total Loan Debt**	**(220.55)**
(51.16)	Other Long Term Liabilities (including PFI schemes)	(49.51)
(241.56)	**Total External Debt**	**(270.06)**
2.56	Investments Managed in house	3.10
(239.00)	**(Net Borrowing) Net Investment Position**	**(266.96)**

Table 2 -Capital Financing Requirement

Newport City Council Gross to Net Borrowing Requirement (Projections)				
	31-Mar-16 (actual)	31-Mar-17	31-Mar-18	31-Mar-19
Gross CFR	362,300	286,300	286,600	283,800
Less: Deferred Liabilities (nominal value)	-49,000	-46,800	-44,600	-42,600
Borrowing CFR	**313,300**	**239,500**	**242,000**	**241,200**
Less: External Borrowing (nominal value)	**-247,700**	**-246,600**	**-205,600**	**-204,500**
Gross Borrowing Requirement/Internal Borrowing	**65,600**	**-7,100**	**36,500**	**36,700**
Less: Usable Reserves	-101,400	-89,700	-85,900	-82,300
Plus: Working Capital Required	8,000	8,000	8,000	8,000
(Investments)/New Borrowing	**-27,800**	**-88,700**	**-41,400**	**-37,600**

- Gross CFR – This is calculated based on the Capital Assets held by the Council plus any planned additional capital expenditure during the year.
- Deferred Liabilities – This is calculated based on actual PFI Schemes and Finance lease liabilities, plus any planned new leases or schemes for each year.
- External Borrowing – This is calculated based on actual borrowing, adjusted for external loans maturing.
- Useable Reverses – This is calculated based on actual reserve balances, plus any projected movements for each financial year.

Advisors

24. Arlingclose were the Council's treasury management advisors during 2015/16. In that period, the service provided by Arlingclose continued to meet the requirements of the tender and our expectations.

Prudential Code Indicators

25. Appendix C to this report summarises the prudential code indicators relevant to Treasury Management for 2015/16 as previously set and compares them to the actual position. The figures indicate that the Council was in compliance with all of the indicators in 2015/16.

Financial Summary

There are no cost implications arising from this report

Risks

Risk	Impact of Risk if it occurs* (H/M/L)	Probability of risk occurring (H/M/L)	What is the Council doing or what has it done to avoid the risk or reduce its effect	Who is responsible for dealing with the risk?
Investment counterparty not repaying investments	High but depending on investment value	Low	The Council only invests with Institutions with very high credit scores. It employs advisors to monitor moneymarket movements and changes to credit scores and acts immediately should things change adversely. The lower levels of funds available for investment will also alleviate the risk.	Head of Finance, Treasury staff, treasury advisors
Interest Rates moving adversely against expectations	Low	Low	Base and short term Interest rates are expected to remain at current levels until Q3 2016. The Treasury strategy approved allows for the use of short term borrowing once investment funds are exhausted to take advantage of these low rates.	Head of Finance, Treasury staff, treasury advisors

* Taking account of proposed mitigation measures

Links to Council Policies and Priorities

It is the Council's policy to ensure that the security of the capital sums invested is fully recognised and has absolute priority. The Council follows the advice of the Welsh Assembly Government that any investment decisions take account of security, liquidity and yield in that order.

Options Available

The Prudential Code and statute requires that, during and at the end of each financial year, reports on these matters are presented to members for consideration. Thus the only option available is to consider this report.

Preferred Option and Why

The preferred choice is to receive and note the contents of the report.

Comments of Chief Financial Officer
Comments of the Chief Financial Officer are those as detailed in the report.

Comments of Monitoring Officer
There are no legal implications. This annual Treasury Management Report is in accordance with the requirement of the Local Government Act 2003 and is consistent with relevant Chartered Institute of Public Finance and Accountancy Guidance, Treasury Management principles and the Council's Investment Strategy. The Annual report confirms that the Council's capital financing and investment activity in 2015/16 was in line with the pre-set Prudential Indicators and Treasury Management Strategy.

Staffing Implications: Comments of Head of People and Business Change
There are no human resources implications within the report.

Comments of Cabinet Member
N/A.

Local issues
There are no local issues from this report.

Scrutiny Committees
N/A

Equalities Impact Assessment
These proposals do not require Equalities Impact Assessment.

Children and Families (Wales) Measure
N/A

Consultation
As per report

Background Papers
Credit Rating Data received via Arlingclose

Report to Cabinet February 2015: Medium Term Financial Plan and 2015/16 budget

Report on Treasury Management for the period to 30 September 2015

List of Appendices

Appendix A – Loan Debt Activity 2015/2016
Appendix B – Economic Summary 2015/2016
Appendix C – Prudential Code – Review of 2015/2016 Treasury Management Indicators

Dated: 12 May 2016

APPENDIX A

LOAN DEBT AND INVESTMENT ACTIVITY 2015/16 FINANCIAL YEAR

Newport City Council Debt	Outstanding as at 01/04/15	Raised	Repaid	Outstanding as at 31/03/2016
	£000s	**£000s**	**£000s**	**£000s**
Public Works Loans Board	70,131	22,922	(20,616)	72,437
Market Loans	35,000	-	-	35,000
Stock Issue	40,000	-	-	40,000
Queensberry Borrowing	34,975	58,000	(20,000)	72,975
Other Loans (IFRS)	304	-	(166)	138
Total Long Term Loans	**180,410**	**80,922**	**(40,782)**	**220,550**
Temporary Debt	10,000	62,960	(72,960)	-
Total Long Term and Temporary Debt	**190,410**	**143,882**	**(113,742)**	**220,550**

Total Investments Administered Newport City Council	Outstanding as at 01/04/15	Raised	Repaid	Outstanding as at 31/03/2016
	£000s	**£000s**	**£000s**	**£000s**
ST Investments	2,560	596,870	(596,330)	3,100

Appendix B

ECONOMIC ACTIVITY REVIEW – 2015/16

Growth, Inflation, Employment: The UK economy slowed in 2015 with GDP growth falling to 2.3% from a robust 3.0% the year before. CPI inflation hovered around 0.0% through 2015 with deflationary spells in April, September and October. The prolonged spell of low inflation was attributed to the continued collapse in the price of oil from $67 a barrel in May 2015 to just under $28 a barrel in January 2016, the appreciation of sterling since 2013 pushing down import prices and weaker than anticipated wage growth resulting in subdued unit labour costs. CPI picked up to 0.3% year/year in February, but this was still well below the Bank of England's 2% inflation target. The labour market continued to improve through 2015 and in Q1 2016, the latest figures (Jan 2016) showing the employment rate at 74.1% (the highest rate since comparable records began in 1971) and the unemployment rate at a 12 year low of 5.1%. Wage growth has however remained modest at around 2.2% excluding bonuses, but after a long period of negative real wage growth (i.e. after inflation) real earnings were positive and growing at their fastest rate in eight years, boosting consumers' spending power.

Global influences: The slowdown in the Chinese economy became the largest threat to the South East Asian region, particularly on economies with a large trade dependency on China and also to prospects for global growth as a whole. The effect of the Chinese authorities' intervention in their currency and equity markets was temporary and led to high market volatility as a consequence. There were falls in prices of equities and risky assets and a widening in corporate credit spreads. As the global economy entered 2016 there was high uncertainty about growth, the outcome of the US presidential election and the consequences of June's referendum on whether the UK is to remain in the EU. Between February and March 2016 sterling had depreciated by around 3%, a significant proportion of the decline reflecting the uncertainty surrounding the referendum result.

UK Monetary Policy: The Bank of England's MPC (Monetary Policy Committee) made no change to policy, maintaining the Bank Rate at 0.5% (in March it entered its eighth year at 0.5%) and asset purchases (Quantitative Easing) at £375bn. In its *Inflation Reports* and monthly monetary policy meeting minutes, the Bank was at pains to stress and reiterate that when interest rates do begin to rise they were expected to do so more gradually and to a lower level than in recent cycles.

Improvement in household spending, business fixed investment, a strong housing sector and solid employment gains in the US allowed the Federal Reserve to raise rates in December 2015 for the first time in nine years to take the new Federal funds range to 0.25%-0.50%. Despite signalling four further rate hikes in 2016, the Fed chose not to increase rates further in Q1 and markets pared back expectations to no more than two further hikes this year.

However central bankers in the Eurozone, Switzerland, Sweden and Japan were forced to take policy rates into negative territory. The European Central Bank also announced a range of measures to inject sustained economic recovery and boost domestic inflation which included an increase in asset purchases (Quantitative Easing).

Market reaction: From June 2015 gilt yields were driven lower by the a weakening in Chinese growth, the knock-on effects of the fall in its stock market, the continuing fall in the price of oil and commodities and acceptance of diminishing effectiveness of central bankers' unconventional policy actions. Added to this was the heightened uncertainty surrounding the outcome of the UK referendum on its continued membership of the EU as well as the US presidential elections which culminated in a significant volatility and in equities and corporate bond yields.

10-year gilt yields moved from 1.58% on 31/03/2015 to a high of 2.19% in June before falling back and ending the financial year at 1.42%. The pattern for 20-year gilts was similar, the yield rose from 2.15% in

March 2015 to a high of 2.71% in June before falling back to 2.14% in March 2016. The FTSE All Share Index fell 7.3% from 3664 to 3395 and the MSCI World Index fell 5.3% from 1741 to 1648 over the 12 months to 31 March 2016.

Appendix C

PRUDENTIAL CODE – REVIEW OF 2015/2016 TREASURY MANAGEMENT INDICATORS

The CIPFA Prudential Code covers the control of capital expenditure and Treasury Management issues. This report deals with the Treasury Management aspects of the Code. The Code requires actual outturn against the Indicators set under the Code to be reported to Council.

The Authority confirms compliance with its prudential indicators for 2015/16, which were agreed by Cabinet/Council in February 2015. The following lists each of the indicators and provides the actual position against each, with comments to explain any significant variation.

Capital Financing Requirement

The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. The calculation of the CFR is taken from the amounts held in the Balance Sheet relating to capital expenditure and it's financing.

	Estimate £million
Set in February 2015	376.6
Actual at 31 March 2016	362.3

Fixed and Variable Rate Limits

These indicators set upper limits that apply to the amounts outstanding on both fixed and variable interest rates. The indicators set and actual at 31 March 2016 were:

	Fixed %	Variable %
Set in February 2015	100	50
Actual at 31 March 2016	100	0

The indicators set upper and lower limits (expressed as a percentage) to the amount of borrowing the Council was prepared to have outstanding in various set periods. The following table shows firstly the levels set in February 2015 and applicable throughout 2015/16 and then the actual position based on debt outstanding at 31 March 2016.

	Indicator Set		Actual
	Upper Limit %	Lower Limit %	%
Under 12 months	40	0	15
12 months and within 24 months	20	0	18
24 months and within 5 years	70	0	19
5 years and within 10 years	50	0	18
10 years and within 20 years	30	0	6
20 years and within 30 years	20	0	8
30 years and within 40 years	20	0	1
40 years and within 50 years	20	0	7
50 years and above	20	0	8

Upper Limit for Total principal sums invested for periods longer than 364 days

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

	Total
Indicator Set	4,000,000
Actual at 31 March 2016	0

Authorised Limit and Operational Boundary for External Debt

The Local Government Act 2003 requires the Authority to set an Affordable Borrowing Limit, irrespective of their indebted status. This is a statutory limit which should not be breached, unless Council authorises an increase to this limit.

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 Authority confirms that there were no breaches to the Authorised Limit and the Operational Boundary during 2015/16 at the end of the financial year:

	Authorised Limit 2015/16 £000s	Operational Boundary 2015/16 £000s	**Actual External Debt** as at 31/03/2016 £000s
Borrowing	299,000	269,000	220,550
Other Long-term Liabilities	49,000	49,000	49,510
Total	**348,000**	**318,000**	**270,060**