Agenda Item No:10

TREASURY MANAGEMENT QUARTER FOUR AND OUTTURN REPORT

To:	**General Purposes Committee**
Meeting Date:	**31st May 2016**
From:	**Chief Finance Officer**
Electoral division(s):	**All**
Forward Plan ref:	**Not applicable** *Key decision:* **No**
Purpose:	**To provide the fourth quarterly update and outturn report on the Treasury Management Strategy 2015-16, approved by Council in February 2015.**
Recommendation:	**The General Purposes Committee is recommended to:**

a) Note the Treasury Management Outturn Report 2015-16 and forward to full Council for approval.

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1. BACKGROUND

1.1 Treasury Management is governed by the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management (the Code). The Code has been developed to meet the needs of Local Authorities and its recommendations provide a basis to form clear treasury management objectives and to structure and maintain sound treasury management policies and practices.

1.2 The Code was adopted via the Treasury Management Strategy Statement (TMSS), which was approved by Council in February 2015. It requires the Council to produce an annual treasury report and a half yearly report. Alongside these, General Purposes Committee are also provided with quarterly updates on progress against the Strategy.

1.3 This report has been developed in consultation with the Council's external investment manager and treasury adviser, Capita Asset Services (CAS) and provides an update for the fourth quarter to 31st March 2016.

1.4 The report is based on forecasts and estimates and may change once the accounts are closed.

2. SUMMARY OF KEY HEADLINES

2.1 The main highlights for the quarter are:

- Investment returns received on cash balances compares favourably to the benchmarks. A return of 0.65% was achieved compared to the 3 month London Interbank Bid Rate (LIBID) benchmark of 0.46% (see section 6).

- Overall an underspend of £12.666m has been achieved for debt charges this year. £9.8m was directly attributable to a change in Minimum Revenue Provision (MRP) policy approved and implemented during the year. Careful management of the council's balance sheet and a strategy of internal borrowing have meant that costly external long term loans have been avoided generating net £2.8m (see section 8 for further details).

3. THE ECONOMIC ENVIRONMENT

3.1 A detailed economic commentary is provided in **Appendix 1**. This information has been provided by Capita Asset Services – Treasury Solutions (CAS Treasury Solutions), the Council's treasury management advisors.

3.2 During the quarter ended 31st March 2016, the significant UK headlines of this analysis were:

- The economic recovery struggled for momentum;
- Household spending remained the primary driver of growth;
- Soft pay growth was still at odds with a tightening labour market;
- Falling energy prices helped to keep inflation low;
- The prospect of a rate hike before late 2016 remained unlikely;
- The Fed held interest rates unchanged;

- The European Central Bank (ECB) embarked on further quantitative easing;
- The Chancellor pencilled in even more fiscal austerity in 2019/20.

4. SUMMARY PORTFOLIO POSITION

4.1 A snapshot of the Council's debt and investment position is shown in the table below:

	TMSS Forecast February 2015 (as agreed by Council)		Actual as at 31 March 2015		Actual as at 31 March 2016	
	£m	Rate %	£m	Rate %	£m	Rate %
Long term borrowing						
PWLB	384.0		301.6		278.6	4.3
Market	79.5		79.5		79.5	3.7
Total long term	**463.5**	**4.2**	**381.1**	**4.1**	**358.1**	**4.2**
Short term borrowing	-	-	-	-	-	-
Total borrowing	**463.5**	**4.2**	**381.1**	**4.1**	**358.1**	**4.2**
Investments	**10.6**	**0.7**	**35.6**	**0.5**	**10.1**	**0.5**
Total Net Debt / Borrowing	**452.9**	**-**	**345.5**	**-**	**348.0**	**-**
3rd Party Loans & Share Capital	**-**	**-**	**-**	**-**	**0.4**	**-**

4.2 The portfolio position at 31st March 2016 is considerably different to the original forecasts set out in the Treasury Management Strategy Statement in February 2015. Net borrowing is considerably less than originally forecast which is due to a number of factors, which will be assessed in greater detail during a balance sheet review once the accounts are closed. A summary of this review will be provided in next quarter's report. The likely reasons are due to combination of slippage in the capital programme and greater levels of cash reserves than originally forecast.

4.3 Further analysis of borrowing and investments is covered in the following two sections.

5. BORROWING

5.1 The Council can take out loans in order to fund spending for its Capital Programme. The amount of new borrowing required is determined by capital expenditure plans and projections of the Capital Financing Requirement, forecast reserves and current and projected economic conditions.

New loans and repayment of loans:

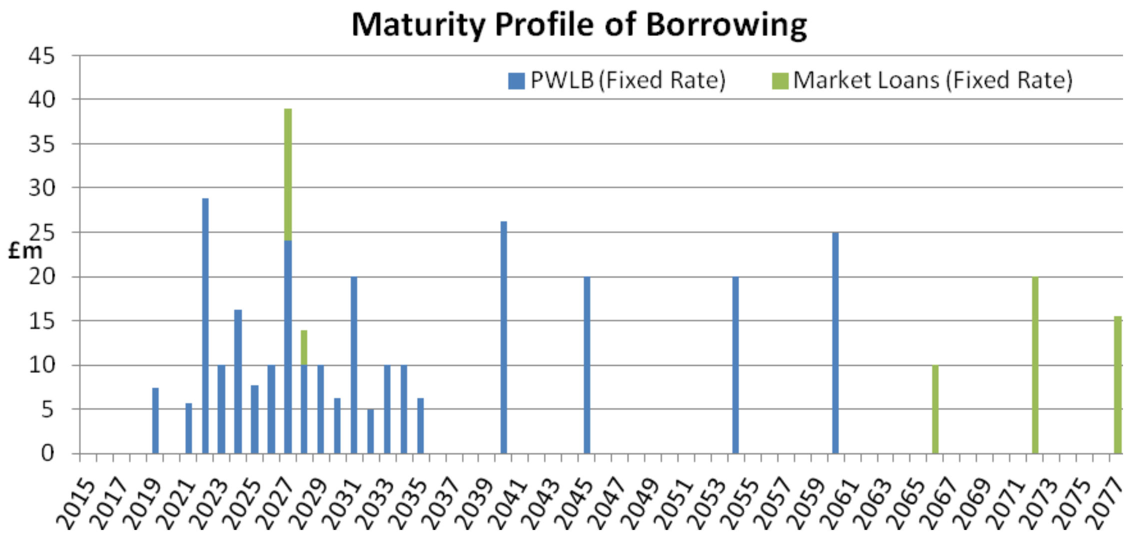
5.2 The table below shows the details new loans raised and loans repaid during 2015-16. No new loans were raised during quarter.

Lender	Raised / Repaid	Start Date	Maturity Date	£m	Interest Rate %	Duration (yrs)
PWLB	Repaid	31/03/2011	30/09/2015	15.00	3.34%	4.5
PWLB	Repaid	05/01/2001	13/01/2016	8.043	4.88%	15.0

Maturity profile of borrowing:

5.3 The following graph shows the maturity profile of the Council's loans. The majority of loans have a fixed interest rate and are long term which limits the Council's exposure to interest rate fluctuations. The weighted average years to maturity of the portfolio (assuming Lender Option Borrowing Option (LOBO) Loans run to maturity) is 24.2 years.

5.4 The presentation below differs from that in **Appendix 2** paragraph 4, in that LOBO loans are included at their final maturity rather than their next call date. In the current low interest rate environment the likelihood of the interest rates on these loans being raised and the loans requiring repayment at the break period is extremely low.



5.5 A £15m loan matured on the 30th September was not replaced and instead was repaid with surplus cash. Another Public Works Loan Board (PWLB) loan of £8m matured in January 2016 and has not been replaced.

Loan restructuring:

5.6 When market conditions are favourable long term loans can be restructured to:

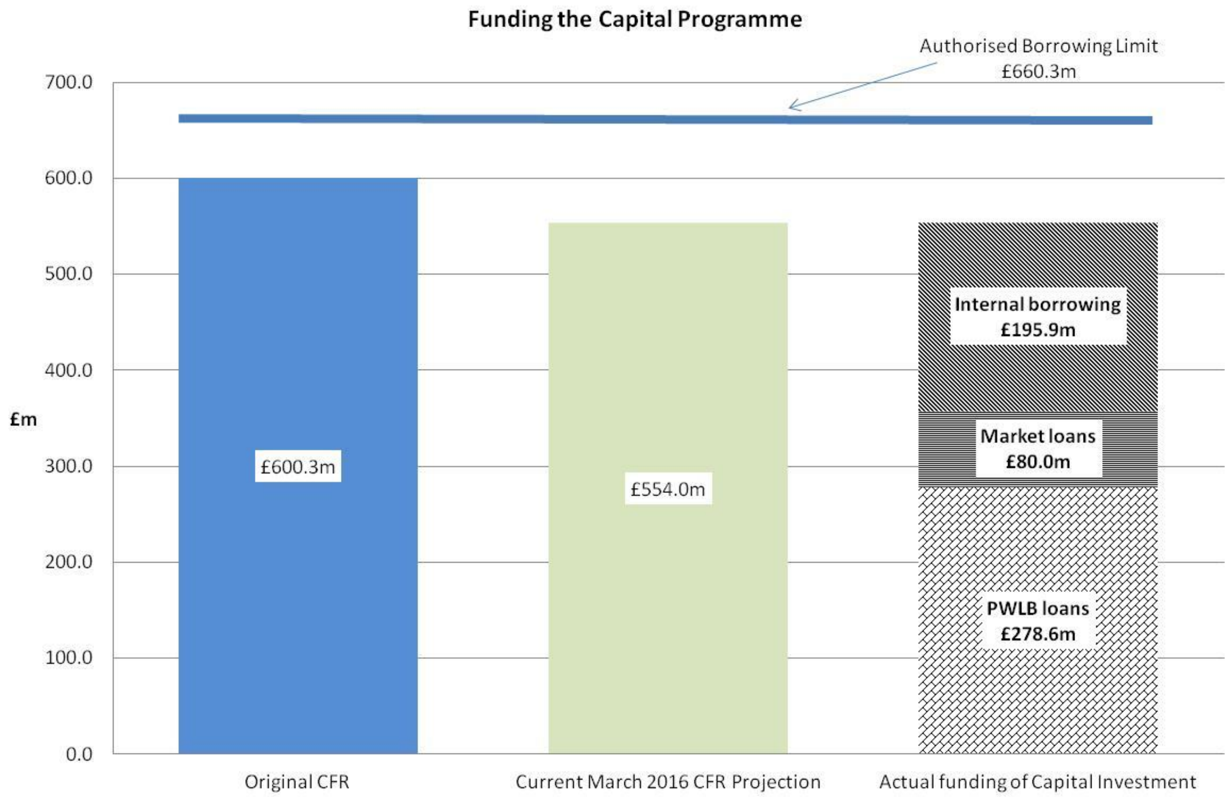
- to generate cash savings
- to reduce the average interest rate
- to enhance the balance of the portfolio by amending the maturity profile and/or the level of volatility. (Volatility is determined by the fixed/variable interest rate mix.)

5.7 During the quarter there were no opportunities for the Council to restructure its borrowing due to the position of the Council's borrowing portfolio compared to market conditions. Debt rescheduling will be considered subject to conditions being favourable but it is unlikely that opportunities will present themselves during this year. The position will be kept under review, and when opportunities for savings do arise, debt rescheduling will be undertaken to meet business needs.

Funding the Capital Programme:

5.8 The Treasury Management Strategy Statement (TMSS) sets out the plan for treasury management activities over the next year. It identifies where the authority expects to be in terms of borrowing and investment levels. When the 2015-16 TMSS was set, it was anticipated that the Capital Financing Requirement (CFR), the Council's liability for financing the agreed Capital Programme, would be £600.3m. This figure is naturally subject to change as a result of changes to the approved capital programme.

The graph below compares the maximum the Council could borrow in 2015-16 with the forecast CFR at 31st March 2016 and the actual position of how this is being financed at 31st March 2016.



5.9 The graph shows the projection for the Capital Financing Requirement (CFR) is significantly below significantly below the statutory Authorised Borrowing Limit set for the Council at the start of the year.

5.10 In addition, the graph shows how the Council is currently funding its borrowing requirement, through internal and external resources. As at 31st March internal borrowing is forecast to be £196m at the end of the year. Internal borrowing is the use of the Council's surplus cash to finance the borrowing liability instead of borrowing externally. The strategy of internally borrowing, by careful management of the Council's balance sheet, is currently the most appropriate strategy, given the current interest rate environment. This strategy enables savings to be generated and reduces the level of cash invested and credit risk associated with investing. However the projected level of internal borrowing may not be sustainable in the future, so short term loans from the PWLB and other sources are currently being considered and will be raised as required.

6. INVESTMENTS

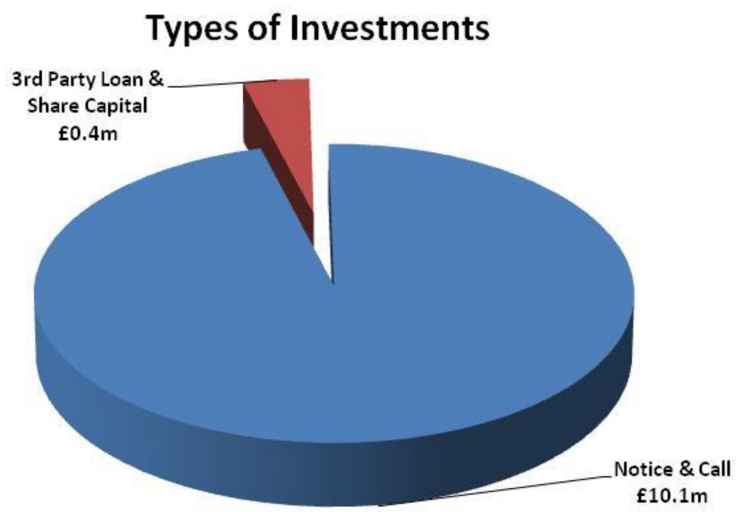
6.1 Investment activity is carried out within the Council's counterparty policies and criteria, and with a clear strategy of risk management in line with the Council's treasury strategy for 2015-16. This ensures that the principle of considering security, liquidity and yield, in that order (SLY), is consistently applied. The Council will therefore aim to achieve the optimum return on investments commensurate with proper levels of security and liquidity. Any variations to agreed policies and practices are reported to General Purposes Committee and

Council.

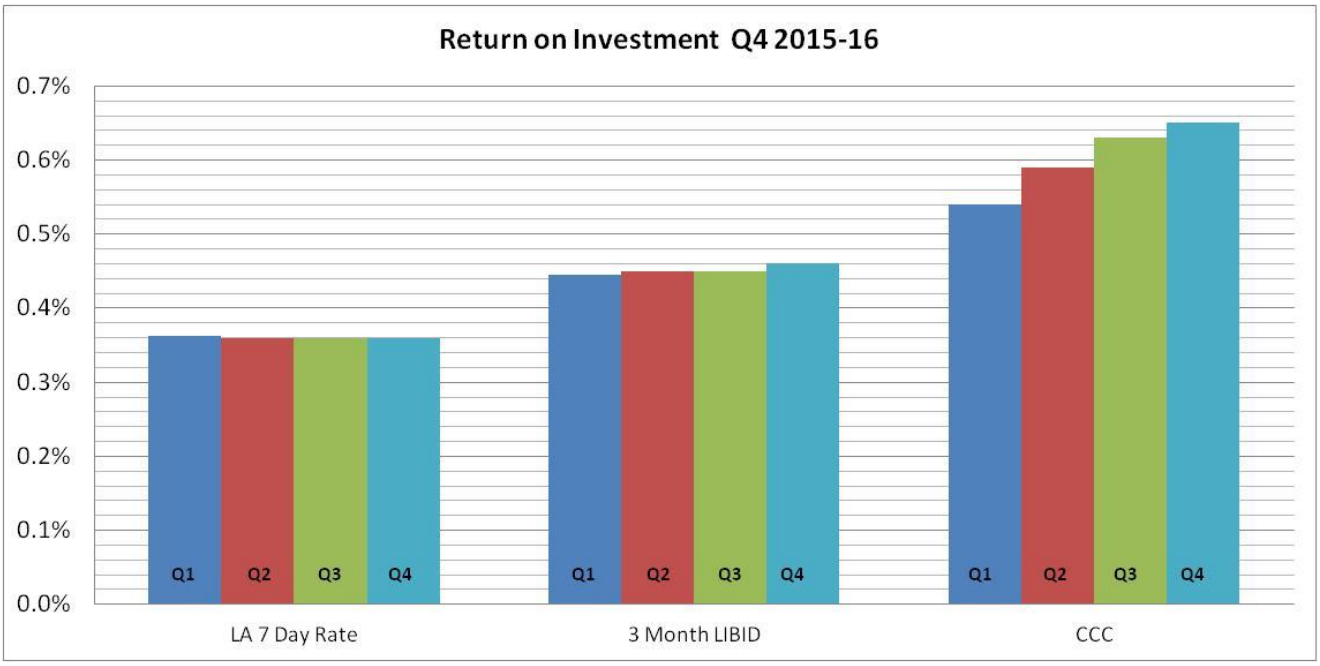
6.2 As described in paragraph 5.10, the strategy currently employed by the Council of internal borrowing also has the affect of limiting the Council's investment exposure to the financial markets, thereby reducing credit risk.

6.3 As at 31st March the level of investment totalled £10.1m, excluding 3rd party loans and share capital which are classed as capital expenditure. The level of cash available for investment is as a result of reserves, balances and working capital the Council holds. These funds can be invested in money market deposits, placed in funds or used to reduce external borrowings.

6.4 A breakdown of investments by type are shown in the graph below, with detail at **Appendix 3.** The majority of investments are in notice and call accounts and money market funds to meet the liquidity demands for the Council.



6.5 The graph below compares the returns on investments with the relevant benchmarks for each quarter this year



6.6 It can be seen from the graph that investments returned 0.65% during the quarter significantly more than the both the 7 day (0.36%), 3 month London Interbank Bid Rate (LIBID) (0.46%) benchmarks.

6.7 Where appropriate, investments can be locked out for periods of up to one year with nationalised banks (UK Government backed) at higher rates of interest. The policy does allow for longer durations should the value make it worthwhile. In a rising interest rate environment it is generally appropriate to keep investments fairly short in duration to take advantage of interest rate rises as soon as they occur. The weighted average time to maturity of investments at 31st March is one day.

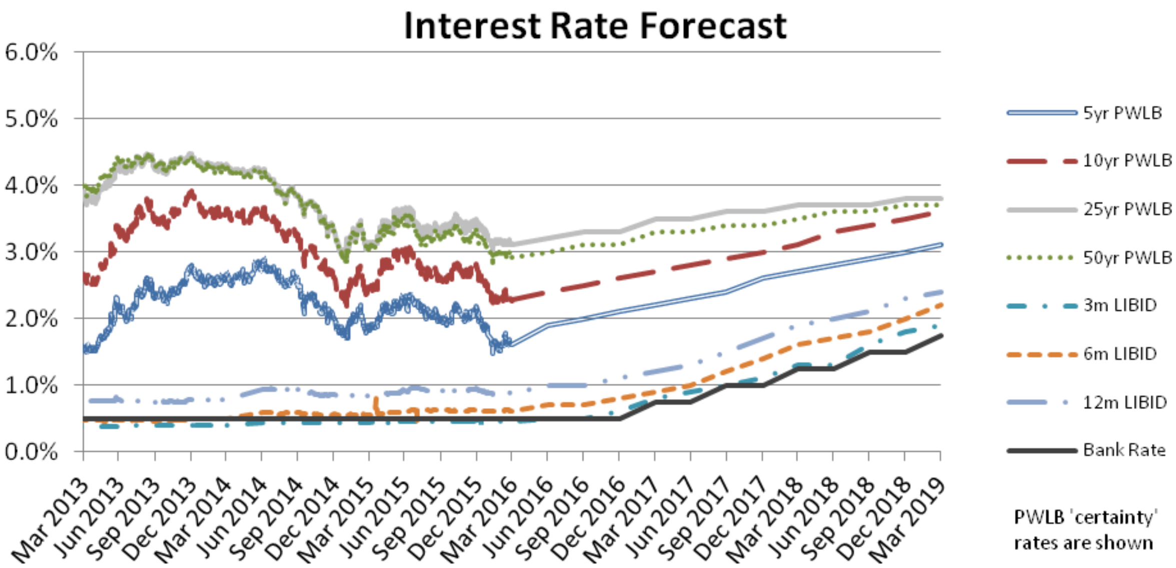
6.8 Leaving market conditions to one side, the Council's return on investment is influenced by a number of factors, the largest contributors being the duration of investments and the credit quality of the institution or instrument. Credit risk is a measure of the likelihood of default and is controlled through the creditworthiness policy approved by Council. The duration of an investment introduces liquidity risk; the risk that funds cannot be accessed when required, and interest rate risk; the risk that arises from fluctuating market interest rates. These factors and associated risks are actively managed by the LGSS Treasury team together with the Council's Treasury Advisors (CAS). Using credit ratings, the investment portfolio's historic risk of default stands at 0.010%. This simply provides a calculation of the possibility of average default against the historical default rates.

6.9 The Council is also a member of a benchmarking group run by CAS which shows that, for the value of risk undertaken, the returns generated are in line with the Model Band (the average range of returns across for all CAS's clients).

7. OUTLOOK

7.1 The current interest rate forecast is shown in the graph below. The forecast for the first increase in Bank Rate has been pushed back from calendar quarter 4 to quarter 1 2017. However there are risks to this central forecast as the economic recovery in the UK is currently finely balanced.

7.2 Geopolitical events, sovereign debt crisis developments and slowing emerging market economies make forecasting PWLB rates highly unpredictable in the shorter term. The general expectation for an eventual trend of gently rising gilt yields and PWLB rates is expected to remain unchanged, as favourable fundamentals will focus on the high volume of gilt issuance in the UK and of bond issuance in other major western countries.



7.3 From a strategic perspective, the Council is continually reviewing options as to the timing of any potential borrowing and also the alternative approaches around further utilising cash balances and undertaking shorter term borrowing which could potentially generate savings subject to an assessment of the interest rate risks involved. Cash flows in the last couple of years have been sufficiently robust for the Council to use its balance sheet strength and avoid taking on new borrowing, however projections now show that new borrowing will be required over the coming year unless there is substantial slippage in the capital programme.

8. DEBT FINANCING BUDGET

8.1 Overall an under spend of £12.666m has been achieved within Debt Charges. £9.8m resulted from a change in MRP policy approved and implemented during the year, which will also deliver base budget savings over the life of the business plan. The remaining variances are largely due to deploying a strategy of internal borrowing resulting in lower that budgeted interest payable.

	Budget	Estimated Outturn	Variance
	£m	£m	£m
Interest payable	17.349	15.476	-1.873
Interest receivable	-0.422	-0.706	-0.284
Other	0.527	0.422	-0.105
Technical	-0.085	-0.065	0.020
MRP	18.091	7.667	-10.424
Total	**35.460**	**22.794**	**-12.666**

8.2 Although there is link between the capital programme, net borrowing and the revenue budget, the Debt Charges budget is impacted by the timing of long term borrowing decisions. These decisions are made in the context of other factors including, interest rate forecasts, forecast levels of cash reserves and the borrowing requirement for the Council over the life of the Business Plan and beyond.

9. MUNICIPAL BONDS AGENCY

9.1 The Framework Agreement and Joint and Several Guarantee were approved by Council in February 2016. The approval now allows the Council to enter into the agreements with the Municipal Bonds Agency (MBA) and raise loans. The timescales for issuance of the first bond are now dependent on other local authorities' approval processes and demand for borrow from local authorities.

10. COMPLIANCE WITH TREASURY LIMITS AND PRUDENTIAL INDICATORS

10.1 With effect from 1st April 2004 The Prudential Code became statute as part of the Local Government Act 2003 and was revised in 2011.

10.2 The key objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of the Council are affordable, prudent and sustainable. To ensure compliance with this the Council is required to set and monitor a number of Prudential Indicators.

10.3 During the financial year to date the Council has operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Management Strategy Statement (TMSS) and in compliance with the Council's Treasury Management Practices. The Prudential and Treasury Indicators are shown in **Appendix 2.**

11. ALIGNMENT WITH CORPORATE PRIORITIES

11.1 **Developing the local economy for the benefit of all**

There are no significant implications for this priority.

11.2 Helping people live healthy and independent lives

There are no significant implications for this priority.

11.3 Supporting and protecting vulnerable people

There are no significant implications for this priority.

12. SIGNIFICANT IMPLICATIONS

12.1 Resource Implications

This report provides information on performance against the Treasury Management Strategy. Section 8 shows the impact of treasury decisions which are driven by capital spend on the Council's revenue budget.

12.2 Statutory, Risk and Legal Implications

The Council continues to operate within the statutory requirements for borrowing and investments. Further details can be found within the Prudential Indicators in Appendix 2.

12.3 Equality and Diversity Implications

There are no significant implications within this category.

12.4 Engagement and Consultation Implications

There are no significant implications within this category.

12.5 Localism and Local Member Involvement

There are no significant implications within this category.

12.6 Public Health Implications

There are no significant implications within this category.

List of Appendices

Appendix 1: Economic Update (provided by Capita Asset Services Treasury Solutions)

Appendix 2: Capital and Treasury Prudential Indicators

Appendix 3: Investment Portfolio

Source Documents	Location
None	Box No: RES1211 Room No:301 Shire Hall, Castle Hill Cambridge CB3 0AP

Appendix 1

Economic Update (provided by CAS Treasury Solutions)

Quarter ending 31st March 2016

1. The economic recovery had a little more momentum than previously thought in Q4 2015, with real GDP growth revised upwards from 0.5% q/q to 0.6% and the annual growth rate from 2.2% to 2.3%. Quarterly growth was higher than in Q3, as the drag from net trade eased significantly. But the imbalances in the economy worsened, with the current account the largest on record at 7.0% of GDP and the savings ratio at an all-time low. Recent surveys suggest that the recovery may have lost some pace in Q1. For example, the Markit/CIPS composite PMI is consistent with quarterly GDP growth weakening to a relatively subdued 0.3%, while the CBI's composite growth indicator points to a marked slowdown in the pace of economic growth in Q1.

2. The official data available for Q1 2016 so far generally corroborate the picture painted by the surveys. Construction output, which had increased in Q4, fell by 0.2% on the month in January. While industrial production and the index of services both increased at the start of the year, they both rose by only 0.2% compared to the previous month.

3. However, the consumer recovery is still going strong, with household spending the main driver of economic growth. Although the pace of retail sales growth moderated a little in February's data, annual growth in sales volumes remains a respectable 3.8%. And while survey measures of spending away from the high street, such as the CBI's consumer services sales volumes balance and the Bank of England's agents' scores of consumer services turnover, have ticked down in recent months, both remain comfortably above their post-crisis averages. What's more, the GfK/NOP consumer confidence balance for major purchases remains at a level consistent with a significant pick-up in annual growth of spending on durable goods.

4. The jobs recovery has continued, with employment rising by 116,000 in the three months to January on the previous three months. Admittedly, this represents a slowdown from 206,000 in December, but it was enough to keep the ILO unemployment rate at 5.1%. This is a post-crisis low and only a touch above the Bank of England's 5.0% estimate of the natural rate (i.e. the rate at which further falls become incompatible with the inflation target). The timelier claimant count measure showed unemployment falling further in February. While annual growth in regular pay (ex. bonuses) ticked up to 2.2% at the start of the year, wage growth is still subdued by past standards. This is rather at odds with the tightening labour market.

5. However, it still appears that the labour market is probably not as tight as the unemployment rate alone suggests. The recent strength of jobs growth has partly

relied on rises in self-employment. Indeed, self-employment accounted for almost a quarter of the new jobs created in the three months to January. Also, the proportion of part-time workers who would prefer a full-time role remained elevated in January, while the Bank of England's agents' scores for recruitment difficulties eased.

6. Given the recent weakness in productivity growth, unit labour costs are now growing at around 2%. But MPC members have previously suggested that they may need to see growth above 2% to offset weaker import prices. What's more, Governor Carney has suggested that he would also like to see quarterly GDP growth above trend rates (of about 0.6%) and higher core inflation before voting for a rate rise. So with little progress on these fronts either, a rate hike in the near term remains unlikely.

7. Indeed, the lack of inflationary pressures from outside the labour market only serves to reinforce this view. Despite rising to 0.3% so far this year from an average of 0.1% in Q4, CPI inflation is still far below the Bank of England's 2% target. The price of Brent crude has weakened further this year, dipping below £23pb, which has helped to keep inflation low. And price cuts announced by four major gas suppliers will start to weigh on inflation in March and April. While we do expect inflation to pick up this year as last year's sharp falls in oil and food prices drop out of the annual comparison, and the effect of sterling's appreciation between mid-2013 and mid-2015 fades, the bigger picture is that it is likely to return to target only very slowly. Accordingly, we don't expect the MPC to vote to raise interest rates until around November this year.

8. Like the Bank of England, the Fed kept interest rates unchanged in Q1, citing risks associated with recent "global economic and financial developments". Also, FOMC members now expect only two rate hikes in the US this year, compared to four back in December, despite the fact that their inflation projections are largely unchanged.

9. After disappointing markets with limited stimulus measures late last year, the ECB Governing Council announced a bumper package in March. It expanded monthly asset purchases from €60bn to €80bn, cut the deposit rate to -0.4% and created new targeted measures for lending to eurozone banks. Nonetheless, the euro actually strengthened shortly afterwards, as markets reacted adversely to comments by President Draghi suggesting that interest rates might not fall any further.

10. Turning to the public finances, the Chancellor delivered his Budget in March against the backdrop of downwardly revised OBR forecasts for economic growth. In order to repair the damage to his chances of achieving his fiscal target of a budget surplus in 2019/20, Mr Osborne shifted the timing of corporation tax payments, brought forward investment spending to earlier in the parliament and pencilled in £3.5bn of unspecified departmental spending cuts in 2019/20.

11. Timing issues aside, the measures announced in the Budget confirmed that the fiscal tightening is set to intensify this year. The government's consolidation

package was already far more austere than those faced in other advanced economies and the new measures included in the Budget add a further net fiscal takeaway of £6.1bn over the next five years as a whole. Admittedly, our GDP forecasts are rather more optimistic than the OBR's, and if realised would suggest that the Chancellor won't have to implement quite as much austerity as his current plans imply in order to hit his target. However, this probably won't become clear for a while and in the meantime the fiscal stance is set to tighten markedly, increasing to 0.9% of GDP in 2016/17.

12. Finally, after steep falls in January and February, the FTSE 100 rebounded and ended Q1 just 2% below its level at the start of the year. By comparison, global equities were down by around 1% over the course of Q1. Meanwhile, on a trade-weighted basis, sterling weakened by around 6% in Q1, with worries over the possible impact of a Brexit in particular appearing to weigh on the pound.

Appendix 2

Prudential and Treasury Indicators at 31st March 2016

Monitoring of Prudential and Treasury Indicators: approved by Council in February 2015.

1. **Has the Council adopted CIPFA Code of Practice for Treasury Management in the Public Services?**

   The Council has adopted CIPFA's Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes. This is a key element of the Treasury Strategy 2015-16 which was approved by Council in February 2015.

2. **Limits for exposure to fixed and variable rate net borrowing (Borrowing less investments)**

	Limits	Actual
Fixed rate	150%	89.81%
Variable rate	65%	10.19%
Total		100%

The Interest rate exposure is calculated as a percentage of net debt. Due to the mathematical calculation exposures could be greater than 100% or negative depending upon the component parts of the formula. The formula is shown below:

$$\frac{\textit{Total Fixed (or Variable) rate exposure}}{\textit{Total borrowing – total investments}}$$

Fixed Rate calculation:

$$\frac{\textit{(Fixed rate borrowing £312.6m* - Fixed rate investments £m*)}}{\textit{Total borrowing £358.1m - Total investments £10.1m}} = 89.81\%$$

*Defined as greater than 1 year to run

Variable Rate calculation:

$$\frac{\textit{(Variable rate borrowing £45.5m** - Variable rate investments £10.1m**)}}{\textit{Total borrowing £358.1m - Total investments £10.1m}} = 10.19\%$$

** Defined as less than 1 year to run or in the case of LOBO borrowing the call date falling within the next 12 months.

3. **Total principal sums invested for periods longer than 364 days**

	2015-16 Limit £m	Actual £m
Investment longer than 364 days to run	34.0	0.0

Notes: This indicator is calculated by adding together all investments that have greater than 364 days to run to maturity at the reporting date.

4. **Limits for maturity structure of borrowing**

	Upper Limit	Actual
under 12 months	80%	13%
12 months and within 24 months	50%	1%
24 months and within 5 years	50%	4%
5 years and within 10 years	50%	29%
10 years and above	100%	54%

Note: The guidance for this indicator requires that LOBO loans are shown as maturing at the next possible call date rather than at final maturity.

Affordability

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

2015-16 Original Estimate %	2015-16 Revised Estimate %	Difference %
10.23	6.67	-3.56

This indicator has fallen significantly as a result of a large underspend generated within Debt Charges in respect of MRP during the year.

6. **Estimated incremental impact of capital investment decisions on band D council tax**

2015-16 Original Estimate £	2015-16 Revised Estimate £	Difference £
+13.21	-46.16	-59.37

This indicator has fallen significantly as a result of a large underspend generated within Debt Charges in respect of MRP during the year.

Prudence

7. **Gross borrowing and the Capital Financing Requirement (estimated borrowing liability excluding PFI)**

Original 2015-16 Capital Financing Requirement (CFR) £m	2015-16 CFR (based on latest capital information) £m	Actual Gross Borrowing £m	Difference between actual borrowing and original CFR £m	Difference between actual borrowing and latest CFR £m
600.3	554.0	358.1	242.2	195.9

Capital Expenditure

8. **Estimates of capital expenditure**

For details of capital expenditure and funding please refer to the monthly capital report.

External Debt

9. **Authorised limit for external debt**

2015-16 Authorised Limit £m	Actual Borrowing £m	Headroom £m
660.3	358.1	302.2

The Authorised limit is the statutory limit on the Council's level of debt and must not be breached. This is the absolute maximum amount of debt the Council may have in the year.

10. **Operational boundary for external debt**

2015-16 Operational Boundary £m	Actual Borrowing £m	Headroom £m
630.3	358.1	272.2

The operational boundary is set as a warning signal that debt has reached a level nearing the Authorised limit and must be monitored carefully.

Appendix 3

Investment Portfolio as at 31st March 2015

Class	Type	Deal Ref	Start / Purchase Date	Maturity Date	Counterparty	Rate %	Principal O/S (£)
Deposit	Call	CCC/CE/6 (instant access)	-	-	Barclays Bank plc	0.50	10,051,000.00
Call Total							**10,051,000.00**
Deposit	Share Capital	CCC/59	25/09/14	-	The UK Municipal Bonds Agency	-	400,000.00
Share Capital Total							**400,000.00**
Deposit Total							**10,451,000.00**