Public
Key Decision – No

HUNTINGDONSHIRE DISTRICT COUNCIL

Title/Subject Matter:	Treasury Management Annual Report 2015/16
Meeting/Date:	Overview & Scrutiny Panel (Performance and Customers) – 6th June 2016 Cabinet – 16th June 2016
Executive Portfolio:	Strategic Resources: Councillor J A Gray (Deputy Executive Leader)
Report by:	Head of Resources
Ward(s) affected:	All Wards

Executive Summary:

The Council's 2015/16 Treasury Management Strategy, was approved by Council on the 25th February 2015.

CIPFA's Treasury Management code requires Councils to report on performance of the treasury management function twice a year; the first report being the mid-year review (reported to the Cabinet on the 19th November 2015) and the annual report after the financial year end.

The main purpose of the Treasury Management Strategy is to;

- Ensure the Council has sufficient cash to meet its day to day obligations.
- Borrow when necessary to fund capital expenditure, including borrowing in anticipation of need when rates are considered to be low.
- Invest surplus funds in a manner that balances low risk of default by the borrower with a fair rate of interest.

The key market Treasury Management issues though 2015/16 influencing the Council's decision-making were;

- A moderate improvement in the credit rating of financial institutions.
- The introduction of legislation (bail-in replaces bail-out) placing the burden of rescuing failing EU banks disproportionately onto unsecured institutional investors including local authorities.
- A continuation of the Bank of England's policy of very low interest rates, with the result that market rates also remain very low. The Council average investing rate was 0.41%.

The Council's response to the key issues was;

- Where the Council has surplus funds to primarily make short term investments (the majority on call on a daily basis) in liquidity accounts and money market funds.

- Where possible to take a higher return without sacrificing liquidity.

- When borrowing the Council has used the Public Works Loan Board (PWLB), which offers low fixed rate borrowing over a long period. The average interest rate paid was 3.70%

The Council's Commercial Investment Strategy (CIS)

Towards the end of 2015/16 the Commercial Investment Strategy commenced. Performance of the CIS up to the 31st March 2016 is reported in the "Integrated Performance Report, 2015/16 Quarter 4" that is elsewhere on the agenda. However a summary of the transactions so far is shown in Appendix E.

Recommendation(s):

The Cabinet is recommended to

- Comment on the 2015/16 Treasury Management performance.

1. PURPOSE OF THE REPORT

1.1 To report to Members on the performance of the Treasury Management activity over the past financial year.

2. BACKGROUND

2.1 This report covers treasury activity and the associated monitoring and control of risk. The key areas to be addressed includes:

- Economic Review
- Performance of Funds
- Risk Environment
- Risk Management
- Compliance with Regulations and Codes

2.2 The key points in the 2015/16 Strategy were:

- Ensuring the Council has sufficient cash to meet its day to day obligations.
- Borrowing when necessary to fund capital expenditure.
- Investing surplus funds in a manner that balances low risk of default by the borrower with a fair rate of interest.

3. ANALYSIS

Economic Review

3.1 An economic review of the year has been provided by our Treasury Management advisors, Arlingclose and is attached with an analysis of the local context implications in **Appendix A**. The main reliance to the Council is:

- Interest rates are likely to remain low in the short-term, allowing the Council to borrow at low interest rates both for short-term cash flow purposes and for longer term borrowing, such as the borrowing used to fund the loans to Luminus
- However low rates mean few opportunities to make significant returns from investments. This requires the Council to use other investing opportunities which the Commercial Investment Strategy provides.
- Low inflationary increases are likely in the short-term, reducing pressure on Council budgets of price increases.
- Whilst wages growth has been low or negative in recent years, there is now evidence of increasing wage inflation, as a result of low unemployment rates and high employment rates.

Performance of Council Funds

3.2 The following table summarises the treasury management transactions undertaken during the 2015/16 financial year and the details of the investments and loans held as at 31st March 2016 are shown in detail in **Appendix B**.

	Principal Amount £m	Interest Rate %
Investments		
at 31st March 2015	3.9	1.20
less matured in year	-212.2	
plus arranged in year	+213.6	
at 31st March 2016	5.3	0.78
Average Investments (Annual)	**15.4**	**0.65**
Borrowing		
at 31st March 2015	11.3	3.73
less repaid in year	-0.1	
plus arranged in year	+2.2	
at 31st March 2016	13.4	3.63
Average Borrowing (Annual)	**11.7**	**3.70**

Note;
Interest rates above are as at dated apart from averages, where these are the average for the whole year.

Investments

3.3 The Council's strategy for 2015/16 was based on all investments being managed in-house. The investments were of three types:

- Time deposits, these are deposits with financial institutions that are of fixed term and mature on an agreed date. In the Council's case usually in 1 to 2 weeks.
- Liquidity (call) accounts, these are accounts held with banks where there is no fixed term and the money can be deposited or withdrawn on the day.
- Money Market Funds, these are funds where investor's deposits are aggregated together and invested across a large range of financial products, giving a high degree of diversification.

3.4 The average rate of interest on all investments was 0.67%, 0.31% above the 7 day LIBID (London Interbank Bid Rate) benchmark rate of 0.36%, this represents a return of over three times the bench-mark rate. This good performance was due to £1.375m of the investments being locked into higher rates before the year started together with the use of liquidity accounts with major banks and Money Market Funds which gave the added safety of instant access together with interest rates in excess of the benchmark.

3.5 When only short-term cash flow investment activity is considered, the rate of interest on investments was 0.41%, which is around 14% higher than the 7-day benchmark rate of 0.36%.

Borrowing

3.6 The Council's exposure to interest rate risk at the end of the year was:

- £13.4m long term borrowing from the PWLB, at a weighted average rate of 3.62%.
- Short term borrowing at 31 March 2016 was nil.

3.7 The actual net investment interest payable (after deduction of interest receivable on loans) was £304,000 against a budget of £346,000. This is a saving of £42,000 against the original budget. This is due to delays in capital and revenue expenditure resulting in higher than estimated average cash balances which have been invested.

3.8 In September 2015 Cabinet agreed to make a loan of £5m to Luminus in order to finance part of the cost of constructing care facility at Langley Court St Ives. During the year the Council has advanced £2.25m of funding to Luminus and the Council has in turn borrowed the same amount from the PWLB over a period of 31 years. The remainder of the loan will be advanced in 2016/17 and as a consequence the Council will be borrowing from the PWLB to finance this.

3.9 There was no short-term borrowing during 2015-16 as the Council held sufficient cash balances to meet its obligations.

Risk Environment

3.10 The changes to the environment in which investing takes place are detailed in **Appendix C** the main points to note are;

- Bail in legislation requiring investors to contribute to bank losses has replaced government bail outs.
- Slight improvements in the credit ratings of financial institutions.
- Improvements in the financial strength of financial institutions as evidenced by the Bank of England stress tests.

Risk Management

3.11 The Council's primary objectives for the management of its investments are to give priority to the **security** and **liquidity** (how quickly cash can be accessed) of its funds before seeking the best rate of **return**.

3.12 The Council manages security by investing short-term with highly-rated banks and building societies, as well as investing with local authorities in the UK which are deemed to be intrinsically safe.

3.13 In addition to this the Council makes significant use of a number of Money Market Funds, where a large numbers of investors' funds, including the Council's, are aggregated and spread across a wide range of investments. The Council is therefore able to access a spread of investments across a number of funds not available if it were to invest on its own.

3.14 In order to manage liquidity the Council invests funds in call accounts or Money Market Funds, which provide instant access to funds.

3.15 The Council's priority has been security and liquidity, over the return on investments, which resulted in investments during 2015/16 generally being of short duration (the majority on call). The result of low interest rates across the market is that the margin gained from the benefit of investing for longer period does not out-weigh the potential costs of failure of the investment.

Compliance with Regulations and Codes

3.16 All the treasury management activity undertaken during the financial year complied with the approved strategy, the CIPFA Code of Practice, and relevant legislation.

3.17 The Code requires the Council to approve both Treasury Management and Prudential Indicators. Those for 2015/16 were approved at the Council meeting on 25th February 2015. **Appendix D** shows the relevant prudential indicators and the actual results, the table below is a summary of key indicators.

Prudential Management Indicators			
	2015/16 Estimate	**2015/16 Actual**	**Impact on the Council**
Net capital expenditure	£9.6m	£4.2m	Expenditure less than estimated as a result of rephasing schemes (£1.5m) and underspends (£1.3m).
Expenditure on interest and MRP (Minimum Revenue Provision)	10.4%	9.6%	As a result of underspends in 2014/15 the MRP is lower for 2015/16.
Capital Financing Requirement (CFR)	£44.9m	£35.4m	The CFR is lower due to reduced expenditure detailed above and increased capital receipts.
	31/03/15	**31/03/16**	
Long-term borrowing total	£11.3m	£13.4m	Borrowing has increased to fund the series of loans to Luminus
Treasury Management Indicators			
	2015/16 Limit	**2015/16 Actual**	
Authorised Limit for debt	£84.0m	£17.3m	The Council's debt has increased as a result of loans to finance the Luminus loan, but is still within the approved limits
Operational boundary for debt	£79.0m	£17.3m	
Borrowing fixed and variable interest	75%-100%	100%	All borrowing has been undertaken at a fixed rate to avoid the risk of interest rate increases in the future.
Borrowing repayment profile (10 years)	9%-100%	88%	The loan repayment profile has shortened from last year as the Luminus loans are repaid annually.
Investments longer than 364 days	£33.8m	£0m	Only short-term or instant access investments.

4. COMMENTS OF OVERVIEW & SCRUTINY

4.1 The Overview and Scrutiny Panel (Performance and Customers) considered the Treasury Management Strategy 2015/16 Outturn Report at its meeting held on 6th June 2016. The Panel questioned the purpose of the report however they were informed that the Council has a statutory obligation to report on the Treasury Management of the authority.

4.2 The Panel noted that in regards to the 'Inflation in the Economic Review' section, the report states that 'there is no indication that oil prices will pick up' which conflicts with what Members and residents are experiencing. In addition Members would like the local inflation figure added to the report the next time this report is produced.

5. RISKS

5.1 The risks arising from treasury management activities are highlighted in the report and are measured by reference to the prudential indicators in **Appendix D**.

6. WHAT ACTIONS WILL BE TAKEN

6.1 Treasury management activities will continue to be monitored, in order to mitigate security and liquidity risks.

7. LINK TO THE CORPORATE PLAN, STRATEGIC PRIORITIES AND / OR CORPORATE OBJECTIVES

7.1 Treasury management activity is a corporate function of the Council and supports the achievement of the Councils three corporate priorities; consequently it is a key element in the budget setting and management process.

7.2 In addition, over the last year the Councils Treasury function directly contributed to the "Working with our communities" strategic theme (Corporate Plan 2014-2016) in that it provided loan finance to support an external partner (Luminus) to fund the construction of the Langley Court Extra Care Facility in St. Ives.

8. LEGAL IMPLICATIONS

8.1 No direct, legal implications arise out of this report.

9. RESOURCE IMPLICATIONS

9.1 The resource implications relating to the net interest due to the Council is explained in paragraph 3.7.

10. REASONS FOR THE RECOMMENDED DECISIONS

10.1 The treasury management activity continues to be monitored, to ensure that risk arising are mitigated.

11. LIST OF APPENDICES INCLUDED

Appendix A – Economic review (Source: Arlingclose)
Appendix B – Borrowing and Investments as at 31st March 2016
Appendix C – Risk Environment 2015-16

Appendix D – CIPFA Prudential Indicators
Appendix E – Commercial Investment Strategy Indicators (Preliminary)

BACKGROUND PAPERS
Working papers in Resources
CIPFA Treasury Management Code of Practice

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APPENDIX A

Economic Review of 2015/16	
Economic Growth	**Local Context**
The UK economy slowed in 2015 with GDP growth falling to 2.3% from a robust 3.0% the year before.	The slowdown is likely to delay an increase in interest rates, meaning that returns on investments that the council makes will remain low into the near future.
Inflation	**Local Context**
The prolonged spell of low inflation was attributed to the continued collapse in the price of oil, the increase in the strength of the Pound since 2013 pushing down import prices and weaker than anticipated wage growth resulting in subdued labour costs. CPI picked up to 0.3% year on year in February, but this was still well below the Bank of England's 2% inflation target.	The low rate of inflation will reduce the pressure for inflationary increases. Again this is likely to remain the case for the short-term, as there is still no clear indication that oil prices will pick up.
Labour Market	**Local Context**
The Labour market continued to improve through 2015 and in quarter 1 of 2016, the latest figures (Jan 2016) show 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 (after inflation) real earnings were positive and growing at their fastest rate in eight years.	With employment at a record high then recruiting is likely to become more difficult for the Council, as the number of candidates are likely to reduce. In addition wage growth is starting to pick up, and so whilst general inflation remains low, there is potentially increased pressure to increase the Council's pay by greater percentage than in recent years.
Global Influences	**Local Context**
The slowdown in the Chinese economy became the largest threat 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. 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 the Pound had depreciated by around 3%, a significant proportion of the decline reflecting the uncertainty surrounding the	Whilst the Council is insulated to some extent from global fluctuations, the depreciating pound will make imported goods more expensive, so could have an impact on items such as IT equipment.

referendum result.	
UK Monetary Policy	**Local Context**
The Bank of England's 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 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. This is despite in the US, the Federal Reserve to raising rates in December 2015 for the first time in nine years to take the new Federal funds range to 0.25%-0.50%. Though there was some suggestion of further increases this has not happened. The stronger influence on UK interest rates has been the Eurozone, where Switzerland, Sweden central bankers were forced to take interest rates into negative territory.	The economy's low growth rates and low inflation have resulted in the Bank of England's reluctance to increase interest rates. The main ramification of this for the Council is that the investments that it makes in financial instruments, for example money market funds and call accounts will continue to offer very low rates of return. The Commercial Investment Strategy offers an opportunity to achieve higher returns (yields) but still with a high degree of security. The security is as a result of the ownership of an asset (property) or and investment in assets (Property Funds). An attempt to achieve higher returns using financial investments would result in the taking on of more risky investments.
Market Reaction	**Local Context**
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. 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.	PWLB borrowing rates are based on gilt yields. As a result when the Council needs to borrow the rates are offered is low compared to historic rates. The amount of uncertainty surrounding markets outside the UK increases the downward pressure on yields into the short-term.
Source of Data: Arlingclose Ltd	

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APPENDIX B

BORROWING AND INVESTMENTS AT 31 MARCH 2016

	Short-term Rating		Date Invested/ Borrowed	Amount		Interest Rate	Year of Maturity
	Fitch	Moody's		£m	£m		
Borrowing							
Short-term							
NIL							
Long-term							
PWLB			19/12/08	5.000		3.91%	2057/58
PWLB			19/12/08	5.000		3.90%	2058/59
PWLB			07/08/13	1.156		2.24%	2023/24
PWLB			25/11/15	0.750		3.28%	2046/47
PWLB			19/01/16	1.000		3.10%	2046/47
PWLB			21/03/16	0.500		2.91%	2046/47
					13.406		
Total Borrowing					**13.406**		
Investments In-House							
Investments							
NatWest Current	F1	P2		0.010m		0.00%	On-call
NatWest Liquidity	F1	P2		0.279m		0.25%	On-call
Cambridge Building Society	Not rated			0.100m		0.50%	On-call
Bank of Scotland	F1	P1		0.500m		0.40%	Fixed
Santander	F1	P1		0.450m		0.30%	On-call
Handelsbanken	F1+	P1		0.400m		0.30%	On-call
Barclays	F1	P1		0.400m		0.45%	On-call
Blackrock	AAAmmf			0.350m		0.48%	On-call
Federated	AAAmmf			0.300m		0.48%	On-call
Insight	AAAmmf			0.400m		0.51%	On-call
Legal and General	AAAmmf			0.400m		0.48%	On-call
Standard Life	AAAmmf			0.400m		0.45%	On-call
Total Investments					**3.989**		
Loans							
Alconbury Parish Council	Not rated			0.002m		0.50%	2016/17
Huntingdon Regional College	Not rated			1.174m		3.34%	2023/24
Huntingdon Gym	Not rated			0.057m		5.13%	2023/24
Luminus	Not rated			0.750m		4.78%	2047/48
Luminus	Not rated			1.000m		4.60%	2047/48
Luminus	Not rated			0.500m		4.41%	2047/48
Total Loans					**3.483**		
Total Investments					**7.472**		
Net Borrowing					**5.934**		

Definition of Credit Ratings

Fitch	Rating	Definition
Short term	**F1**	Indicates the strongest intrinsic capacity for timely payment of financial commitments; may have an added "+" to denote any exceptionally strong credit feature.
	F2	Good rated intrinsic capacity for timely payment of financial commitments.
	F3	Fair rated intrinsic capacity for timely payment of financial commitments.
Long-term	**AAA**	Highest credit quality organisations, reliable and stable. 'AAA' ratings denote the **lowest expectation of default risk.** They are assigned only in cases of exceptionally strong capacity for payment of financial commitments.
	AA	Very high credit quality. 'AA' ratings denote **expectations of very low default risk.** They indicate very strong capacity for payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
	AA-	
	A	High credit quality. 'A' ratings denote e**xpectations of low default risk**. The capacity for payment of financial commitments is considered strong. This capacity may, nevertheless, be more vulnerable to adverse business or economic conditions than is the case for higher ratings.
	A-	
	BBB	Good credit quality. BBB ratings indicate **expectations of low default risk**. The capacity for payment of financial commitments is considered adequate, but adverse business or economic conditions are more likely to impair this capacity.
Notes The modifiers "+" or "-" may be appended to a rating to denote relative status within major rating categories.		

APPENDIX C

Risk Environment 2015/16	
Bail In	**Local Context**
During the banking crisis the government, invested large sums of public money into banks in order that they remained solvent, and these are still being paid back by the banks. Legislation over the last year has moved the risk to investors in banks, and due to various exemptions for, for instance retail deposits, risks for public bodies have increased.	Whilst some public bodies will carry higher levels of long-term cash and as a result have a need to invest long term, the Council generally has cash that will be needed in the short-term and as a result places funds where they are accessible in the short-term.
Credit Ratings	**Local Context**
Following the banking crisis the credit ratings of many financial institutions were downgraded. Over the last year there has been a gradual improvement in these ratings as banks have built up capital.	The Council receives monthly updates from its advisors on changes to credit ratings. Whilst the Council maintains deposits on a short-term or available instant basis the risk is reduced from failures, as the Council will be able to withdraw funds as soon as there is an indication of a credit problem. Whereas other investors with longer term fixed investments will not be able to.
Stress Tests	**Local Context**
In December the Bank of England released the result of its latest set of stress tests on the seven largest banks. Whilst RBS and Standard Chartered Bank were the weakest performers the regulator did not require them to take any action as both banks had improved their ratios over the year.	The RBS group includes Natwest the Council's transactional banker. Advice from Arlingclose on the way in which the Council uses Natwest for holding funds is being followed. The Council only maintains balances with of less than £1m, which is instantly accessible.

APPENDIX D

CIPFA Prudential Indicators for Capital Finance in Local Authorities
Prudential Indications and Treasury Management Indications for 2015/16
Comparison of actual results with limits

PRUDENTIAL MANAGEMENT INDICATORS

1. Actual and Estimated Capital Expenditure.

	2015/16 Estimate £m	2015/16 Actual £m
Gross	10.7	6.1
Net	9.6	4.2

2. The proportion of the budget financed from government grants and council tax that is spent on interest and the provision for debt repayment.

2015/16 Estimate	2015/16 Actual
10.4%	9.6%

3. The impact of schemes with capital expenditure on the level of council tax.
This item is only provided to demonstrate affordability at budget setting and has already been superseded by the equivalent figure in the 2016/17 Treasury Management Strategy indicators.

4. The capital financing requirement.
This represents the estimated need for the Authority to borrow to finance capital expenditure less the estimated provision for redemption of debt (the MRP).

2015/16 Estimate £m	2015/16 Actual £m
44.9	35.2

5. Net borrowing and the capital financing requirement.
Net external borrowing as at the 31st March 2016, was £13.4m, this is £21.8m less than the capital financing requirement. Thereby confirming that the council has not borrowed for revenue purposes other than in the short-term for cash flow purposes.

6. The actual external long-term borrowing at 31 March 2016

£13.4m

7. Adoption of the CIPFA Code

The Council has adopted the 2011 edition of the CIPFA Treasury Management Code of Practice.

TREASURY MANAGEMENT INDICATORS

8. The authorised limit for external debt.

This is the maximum limit for borrowing and is based on a worst-case scenario.

	2015/16 Limit £m	**2015/16 Actual £m**
Short-Term	18.0	0.0
Long Term	47.0	13.4
Other long-term liabilities (leases)	5.0	0.5
Total	**69.0**	**13.9**
Long-term for loans to organisations	**15.0**	**3.4**
Total	**84.0**	**17.3**

9. The operational boundary for external debt.

This reflects a less extreme position. Although the figure can be exceeded without further approval, it represents an early warning monitoring device to ensure that the authorised limit (above) is not exceeded.

	2015/16 Limit £m	**2015/16 Actual £m**
Short-Term	13.0	0.0
Long Term	47.0	13.4
Other long-term liabilities (leases)	5.0	0.5
Total	**64.0**	**13.9**
Long-term for loans to organisations	**15.0**	**3.4**
Total	**79.0**	**17.3**

Both of these actual results reflect the fact that long term rates were not considered low enough to borrow in anticipation of need

10. Exposure to investments with fixed interest and variable interest.

These limits are given as a percentage of total investments. Investments of less than 12 months count as variable rate.

		Limits		**Actual**
		Max.	**Min.**	**As at 31.3.16**
Borrowing:				
longer than 1 year	Fixed	100%	75%	100%
	Variable	25%	0%	0%
Investments:				
longer than 1 year	Fixed	100%	100%	0%
	Variable	0%	0%	0%

11. Borrowing Repayment Profile

The proportion of 2015/16 borrowing that matured in successive periods.

Borrowing	Upper limit	Lower limit	Actual As at 31.3.16
Under 12 months	90%	0%	1%
12 months and within 24 months	90%	0%	1%
24 months and within 5 years	90%	0%	5%
5 years and within 10 years	91%	1%	5%
10 years and above	100%	9%	88%

12. Investment Repayment Profile

Limit on the value of investments that cannot be redeemed within 364 days.

	Limit £m	Actual £m
Limit on principal invested beyond year end (31 March 2016)	33.8	0

APPENDIX E

Commercial Investment Strategy Indicators

The Treasury Management Strategy for 2016/17 includes three indicators specific to the Commercial Investment Strategy (CIS);

- Investment cover ratio
- Loan to value ratio
- Target income returns

It is at this stage too early to in the lifecycle of the CIS to report on these indicators; however the basis metrics are;

	Purchase Cost £000	**Income (Part-Year) £000**
CCLA Property Shares	2,500	19,700
Unit 3 Stonehill, Huntingdon	1,358	13,700