Council		Agenda Item:
Meeting Date	**19 October 2016**	
Report Title	**Annual Treasury Management Report 2015/16**	
Cabinet Member	**Cllr Duncan Dewar-Whalley, Cabinet Member for Finance**	
SMT Lead	**Nick Vickers, Head of Finance**	
Head of Service	**Nick Vickers, Head of Finance**	
Lead Officer	**Olga Cole, Management Accountant**	
Key Decision	**No**	
Classification	**Open**	
Forward Plan	**Reference number**	

Recommendations	1. To approve the Treasury Management stewardship report for 2015/16.
	2. To approve the prudential and treasury management indicators within the report.

1. Purpose of Report and Executive Summary

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

1.2 Treasury management is defined as "the management of the local Council's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks".

1.3 Overall responsibility for treasury management remains with the Council. No treasury management activity is without risk; the effective identification and management of risk are integral to the Council's treasury management objectives.

1.4 This report:

- is prepared in accordance with the revised CIPFA Treasury Management Code and the revised Prudential Code;
- details the implications of treasury decisions and transactions;

- gives details of the outturn position on treasury management transactions in 2015/16; and
- confirms compliance with Treasury limits and Prudential Indicators.

1.5 This report was submitted to the Audit Committee on 14 September 2016.

2. Background

Borrowing Requirement and Debt Management

2.1 The overall borrowing position is summarised below:

	Balance on 31/3/2015 £000's	Debt Maturing £000's	New Borrowing £000's	Balance on 31/3/2016 £000's
Capital Funding Requirement	5,106	0	0	4,770
Short Term Borrowing	0	0	0	0
Long Term Borrowing	0	0	0	0
TOTAL EXTERNAL DEBT	**0**	**0**	**0**	**0**
Other Long Term Liabilities (cost of leases for equipment)	753	0	0	550
TOTAL EXTERNAL DEBT	753	0	0	550

2.2 The Council undertook no borrowing in the year but full Council did agree in March 2016 that the Council could borrow externally up to £30m to fund regeneration activity. Business cases when developed will be reported to Cabinet for decision.

2.3 Currently all borrowing is internally financed.

Investment Activity

2.4 The Council held average cash daily balances of £36m during the year - this is an increase of 29% on the previous year. These represented working cash balances, capital receipts and the Council's reserves.

2.5 The Communities and Local Government's (CLG's) Guidance on Investments, revised during 2009/10, reiterated security and liquidity as the primary objectives of a prudent investment policy. Although the Guidance became operative on 1 April 2010, its principal recommendations run parallel to the credit risk management requirements in the revised Treasury Management Code. In the revised Guidance, Specified Investments are those made with a body or scheme of "high credit quality". Both the Guidance and the revised Treasury Management Code emphasise that counterparty credit criteria should not rely on credit ratings alone but should include a wider range of indicators. The revised Code nonetheless requires that ratings assigned by all three rating agencies – Fitch, Moody's and Standard & Poor's – be taken into account and the lowest rating be used.

2.6 The criteria applied by the Head of Finance for the approval of a counter party are:

- Credit rating - a minimum long-term of A-;
- Credit default swaps;
- Share price;
- Reputational issues;
- Exposure to other parts of the same banking group; and
- Country exposure.

2.7 The investments permissible by the 2015/16 Treasury Strategy were:

Investment Instruments – (in sterling)	Limits and Maturity dates
Government backed deposits • The UK government • Gilt Edged Securities	 • Unlimited amount and maturity up to 364 days • Unlimited amount and maturity up to 364 days
Money Market Funds and Collective Investment Schemes	£1.5m limit for AAA rated funds as defined by Fitch, Moody's and Standard and Poor's (funds are held on call).
Major UK banks / building societies. (Barclays, HSBC, Lloyds Banking Group, RBS Group, Santander UK, Nationwide, Standard Chartered, Handelsbanken) unsecured deposits.	£3m limit per counterparty for minimum A- rated institutions as defined by Fitch, and/or equivalent ratings by Moody's and Standard & Poor's. Maximum period 364 days.
Close Brothers	£1m limit
Leeds Building Society	£1m limit
Small UK Building Societies	£250k each or max £1m in aggregate
Major Overseas banks unsecured deposits (to be determined with Arlingclose)	£1m limit per bank
CCLA LAMIT Fund	£1.5m in aggregate
Supranational Bonds	£6m in aggregate
Certificate of Deposits	£3m limit per counterparty
Corporate bond funds	£3m in aggregate

2.8 The maximum duration for deposits is 12 months. The Head of Finance in consultation with the Cabinet Member for Finance may consider longer duration. Bonds can be purchased with a maximum duration of 5 years.

2.9 The application of two European Union directives into UK legislation placed the burden of rescuing failing EU banks disproportionately onto unsecured institutional investors which include local authorities. During the year, all three credit ratings agencies reviewed their ratings to reflect the loss of government support for most financial institutions and the potential for loss given default as a result of new bail-in regimes in many countries. Despite reductions in government support many institutions saw upgrades due to an improvement in their underlying strength and an assessment that that the level of loss given default is low.

2.10 In August duration limits were increased for some UK and European banks, and building societies based on advice from Arlingclose. Those for Close Brothers, Coventry BS, Nationwide BS and Santander UK were increased to 6 months from 100 days and Bank of Scotland, HSBC Bank, Lloyds Bank and Svenska Handelsbanken increased to 13 months from 6 months. The limit for Barclays was unchanged while RBS / NatWest remained suspended from the list as their ratings continue to be below the Council's agreed threshold.

2.11 In December the Bank of England released the results of its latest stress tests on the seven largest UK banks and building societies which showed that the RBS and Standard Chartered Bank were the weakest performers. However, the regulator did not require either bank to submit revised capital plans, since both firms had already improved their ratios over the year.

2.12 The first quarter of 2016 was characterised by financial market volatility and a weakening outlook for global economic growth. In March 2016 the ratings of Standard Chartered Bank were downgraded due to concerns around the profitability and quality of the bank's assets. Taking account of advice from Arlingclose, the bank was suspended from the Council's counterparty list.

2.13 The Council's reserves have increased significantly in recent years due primarily to underspends arising from higher fees and charges income and savings on major contracts, and a surplus on business rates. With Revenue Support Grant disappearing completely from 2020 the Council is in a transition stage to being self-financing. Suitable use of reserves is of fundamental importance in supporting this process and allowing the Council to invest in assets which will give long-term revenue streams which are far higher than the returns likely in the foreseeable future from bank and other deposits.

2.14 The deposits for the year are summarised below:

Investments	Balance on 31/3/15 £'000	Investments Made £'000	Maturities £'000	Balance on 31/03/16 £'000	Average Rate %	Average Life (days)
Short Term Investments	22,300	216,147	(213,082)	25,365	0.65	58
Long Term Investments	1,502	0	(2)	1,500	4.77	Undated
TOTAL INVESTMENTS	**23,802**	**216,147**	**(213,084)**	**26,865**		
Increase/ (Decrease) in Investments				3,063		

2.15 **Liquidity:** In keeping with the CLG's Guidance on Investments, the Council maintained a sufficient level of liquidity through the use of Money Market Funds, overnight deposits and the use of call accounts.

2.16 **Yield:** The Council sought to optimise returns commensurate with its objectives of security and liquidity. The UK Bank Rate was maintained at 0.5% through the year. Short-term money market rates remained at very low levels.

2.17 The Council's budgeted investment income for 2015/16 was £85,000 and the actual income received was £234,000. Of this additional return of £149,000 £77,337 is attributable to a higher level of balances and £71,663 is due to the investment in the CCLA Property Fund which returned 4.77% in the year.

Compliance with Prudential Indicators

2.18 The Council has complied with its Prudential Indicators for 2015/16 which were set as part of the Treasury Management Strategy agreed by Council in February 2015.

2.19 In Appendix I the outturn position for the year against each Prudential Indicator is set out.

Treasury Advisers

2.20 Arlingclose has been the Council's treasury advisers since May 2009. Following a tendering process, Arlingclose were reappointed in 2015. Officers of the Council meet with them regularly and high quality and timely information is received from them.

3. Proposal

3.1 Members are asked to approve the report.

4. Alternative Proposals

4.1 No alternative proposals have been considered and compliance with the CIPFA Code is mandatory.

5. Consultation Undertaken

5.1 Arlingclose have been consulted.

6. Implications

Issue	Implications
Corporate Plan	Supports delivery of the Council's objectives.
Financial, Resource and Property	The Council's Treasury Strategy is agreed annually as part of the budget process.
Legal and Statutory	Need to comply with CLG guidance on treasury management.

Issue	Implications
Crime and Disorder	Not relevant to this report
Sustainability	Not relevant to this report
Health and Wellbeing	Not relevant to this report
Risk Management and Health and Safety	Not relevant to this report
Equality and Diversity	Not relevant to this report

7. Appendices

7.1 Appendix I: Treasury Management and Prudential Indicators

8. Background Papers

None

Appendix I

Treasury Management and Prudential Indicators for 2015/16

1. Background

There is a requirement under the Local Government Act 2003 for local authorities to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the "CIPFA Prudential Code") when setting and reviewing their Prudential Indicators.

2. Gross Debt and the Capital Financing Requirement (CFR)

This is a key indicator of prudence. In order to ensure that over the medium term net debt will only be for a capital purpose, the local authority should ensure that the net debt does not, except in the short term, exceed the total of the capital financing requirement in the preceding year plus the estimates of any additional increases to the capital financing requirement for the current and next two financial years.

The Head of Finance reports that the authority had no difficulty meeting this requirement in 2015/16, nor is there any difficulties envisaged for future years. This view takes into account the proposals in the approved budget.

Gross Debt and the Capital Financing Requirement	**2015/16 Actual £'000**	**2016/17 Estimate £'000**	**2017/18 Estimate £'000**
Gross CFR	4,770	4,374	18,000
Less: Other Long Term Liabilities	(550)	(382)	(181)
Borrowing CFR	**4,220**	**3,992**	**17,819**
Less: Existing Profile of Borrowing	0	0	0
Cumulative Maximum External Borrowing Requirement.	**4,220**	**3,992**	**17,819**

3. 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 Actual £'000**	**2016/17 Estimate £'000**	**2017/18 Estimate £'000**
Total	**2,309**	**2,739**	**50**

Capital expenditure will be financed as follows:

Capital Financing	**2015/16 Actual £'000**	**2016/17 Estimate £'000**	**2017/18 Estimate £'000**
Capital receipts	127	605	35
Grants	1,436	2,104	0
Revenue contributions	746	30	15
Total Financing	**2,309**	**2,739**	**50**

Treasury Management and Prudential Indicators for 2015/16

4. Ratio of Financing Costs to Net Revenue Stream

This is an indicator of affordability, highlighting the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs. The definition of financing costs is set out in the Prudential Code.

The ratio is based on costs net of investment income.

Ratio of Financing Costs to Net Revenue Stream	2015/16 Actual %	2016/17 Estimate %	2017/18 Estimate %
Total	**0.85**	**1.51**	**1.58**

5. Incremental Impact of Capital Investment Decision

This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax levels. The incremental impact on Council Tax is the difference between the total revenue budget requirement of the current approved capital programme and the revenue budget requirement from the capital programme proposed.

Incremental Impact of Capital Investment Decisions	2015/16 Actual £	2016/17 Estimate £	2017/18 Estimate £
Increase/Decrease in Band D Council tax	0.09	(0.04)	0.00

6. 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 its financing.

Capital Financing Requirement	2015/16 Actual £'000	2016/17 Estimate £'000	2017/18 Estimate £'000
Total CFR	**4,770**	**4,374**	**18,000**

7. Actual External Debt

This indicator is obtained directly from the Council's balance sheet. It is the closing balance for actual gross borrowing plus other long-term liabilities. This indicator is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit. The long-term liabilities relate to finance lease arrangements for the provision of leisure management equipment and embedded leases representing the value of equipment for the exclusive use for the Council by its grounds maintenance contractors.

Treasury Management and Prudential Indicators for 2015/16

Actual External Debt as at 31/03/2016	**£'000**
Borrowing	0
Other Long-term Liabilities	550
Total	**550**

8. Authorised Limit and Operational Boundary for External Debt

The Authorised Limit sets the maximum level of external borrowing on a gross basis (i.e., not net of investments) for the Council. It is measured on a daily basis against all external borrowing items on the Balance Sheet (i.e., long and short-term borrowing, overdrawn bank balances and long-term liabilities). This Prudential Indictor separately identifies borrowing from other long-term liabilities such as finance leases. It is consistent with the Council's existing commitments, its proposals for capital expenditure and financing, and its approved treasury management policy statement and practices.

The Authorised Limit has been set on the estimate of the most likely, prudent but not worst case scenario with sufficient headroom over and above this to allow for unusual cash movements.

The Authorised Limit is the statutory limit determined under Section 3(1) of the Local Government Act 2003 (referred to in the legislation as the Affordable Limit).

At the Council meeting on 16 March 2016, Members approved a change to the budget framework to allow for funding to be provided up a maximum borrowing of £30m (minute 607/03/2016).

Authorised Limit for External Debt	**2015/16 Estimate £'000**	**2016/17 Estimate £'000**	**2017/18 Estimate £'000**
Borrowing	5,000	35,000	35,000
Other Long-term Liabilities	2,000	2,000	2,000
Total	**7,000**	**37,000**	**37,000**

The Operational Boundary links directly to the Council's estimates of the CFR and estimates of other cash flow requirements. This indicator is based on the same estimates as the Authorised Limit reflecting the most likely, prudent but not worst case scenario but without the additional headroom included within the Authorised Limit.

Operational Boundary for External Debt	**2015/16 Estimate £'000**	**2016/17 Estimate £'000**	**2017/18 Estimate £'000**
Borrowing	6,000	30,000	30,000
Other Long-term Liabilities	774	382	181
Total	**6,774**	**30,382**	**30,181**

The Head of Finance confirms that there were no breaches to the Authorised Limit and the Operational Boundary during 2015/16.

9. Adoption of the CIPFA Treasury Management Code

Treasury Management and Prudential Indicators for 2015/16

This indicator demonstrates that the Council has adopted the principles of best practise.

The Council adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition* on 22 February 2012.

10. Interest Rate Exposures:

This indicator is set to control the Council's exposure to interest rate risk. The Council calculates these limits on net principal outstanding sums (i.e., fixed rate debt net of fixed rate investments).

Upper Limit	**2015/16 Estimate %**	**2015/16 Actual %**	**2016/17 Estimate %**	**2017/18 Estimate %**
Interest on fixed rate borrowing	100	0	100	100
Interest on fixed rate investments	-100	-52	-100	-100
Upper Limit for Fixed Interest Rate Exposure	**0**	**-52**	**0**	**0**
Interest on variable rate borrowing	100	0	100	100
Interest on variable rate investments	-100	-48	-100	-100
Upper Limit for Variable Interest Rate Exposure	**0**	**-48**	**0**	**0**

As the Council has no borrowing, these calculations have resulted in a negative figure.

11. Maturity Structure of Borrowing

This indicator highlights the existence of any large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates. It is designed to protect against excessive exposures to interest rate changes in any one period, in particular in the course of the next ten years.

Maturity Structure of Borrowing	**Existing level at 31/03/16 %**	**Lower Limit for 2016/17 %**	**Upper Limit for 2016/17 %**
Under 12 months	0	0	100
12 months and within 24 months	0	0	100
24 months and within 5 years	0	0	100
5 years and within 10 years	0	0	100
10 years and above	0	0	100

The Council does not have any external borrowing for capital purposes, and did not need to borrow for cash flow purposes during 2015/16.

Treasury Management and Prudential Indicators for 2015/16

12. Credit Risk

The Council considers security, liquidity and yield, in that order, when making investment decisions.

Credit ratings remain an important element of assessing credit risk, but they are not a sole feature in the Council's assessment of counterparty credit risk.

The Council also considers alternative assessments of credit strength, and information on corporate developments of and market sentiment towards counterparties. The following key tools are used to assess credit risk:

- published credit ratings of the financial institution (minimum A- or equivalent and its sovereign (minimum AA+ or equivalent for non-UK sovereigns):
- sovereign support mechanisms;
- credit default swaps (where quoted);
- share prices (where available);
- economic fundamentals, such as a country's net debt as a percentage of its GDP;
- corporate developments, news, articles, markets sentiment and momentum; and
- subjective overlay.

The only indicators with prescriptive values remain to be credit ratings. Other indicators of creditworthiness are considered in relative rather than absolute terms.

The Head of Finance confirms that there were no breaches to counterparty limits or credit ratings at the time of placing investments.

13. 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 Principal Sums Invested Over 364 Days	2015/16 £'000	2016/17 £'000	2017/18 £'000
Upper Limit Estimate	9,000	10,000	10,000
Actual	1,500	-	-

14. Investment Benchmarking

Average Actual Return on investments 2015/16	Original Estimate Return on Investments 2015/16	Average Bank Rate 2015/16	Average 7 day LIBID Rate 2015/16
0.65%	0.27%	0.50%	0.36%