RHONDDA CYNON TAF COUNTY BOROUGH COUNCIL

MUNICIPAL YEAR 2015-2016

COMMITTEE: COUNCIL		AGENDA ITEM NO.3
16TH December 2015	2015/16 MID YEAR TREASURY MANAGEMENT STEWARDSHIP REPORT	

REPORT OF :

THE GROUP DIRECTOR, CORPORATE AND FRONTLINE SERVICES
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1.0 PURPOSE OF REPORT

1.1 As per Code of Practice requirements, this report provides Members with information on :-

- the Council's Treasury Management activity during the first six months of 2015/16; and
- Prudential and Treasury Indicators for the same period.

2.0 RECOMMENDATIONS

2.1 It is recommended that Members note the content of this report.

3.0 INTRODUCTION

3.1 This report meets the requirements of both the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities.

3.2 The CIPFA Code of Practice on Treasury Management requires a Mid Year Review to be presented to Council. This report fulfils that requirement.

3.3 The Treasury Management function operates within the Strategy approved by Council on the 25th March 2015.

3.4 Treasury Management is defined as:
"The management of a local authority's cash flows, its borrowings and its investments, the management of the associated risks, and the pursuit of the optimum performance or return consistent with those risks".

3.5 The Council sets a balanced budget to ensure that all planned expenditure is financed by various sources of income / reserves. Treasury Management is concerned with monitoring the cashflows of such income and expenditure and planning investments and borrowing prudently.

3.6 This report includes the following areas of treasury activity during the first six months of 2015/16 :

- Economic background;
- Borrowing activity and results;
- Estimated and actual treasury position and prudential indicators;
- Investment strategy, activity and results.

4.0 ECONOMIC BACKGROUND

4.1 General Economic Background

4.2 The Council's investment income is subject to changes in short term interest rates. The level of the Bank Base Rate or 'Bank Rate' is one of the main determinants of the rate of interest the Council receives on its short term investments. The Bank of England continued to maintain the Bank Rate at 0.5% throughout the first half of the year. This is expected to continue until the middle of 2016 and will result in continued low investment income for the Council.

4.3 The UK economy has remained resilient over the last six months. Economic growth slowed in the first quarter but picked up in the second quarter. The main driver of GDP (Gross Domestic Product) growth has been household spending and this remains key, supported by increases in real wages and available disposable income.

4.4 The Monetary Policy Committee's (MPC) general guidance on the Bank Rate remains unchanged. The Governor of the Bank of England, Mark Carney, once again stated the constraints on economic growth meant that increases in the Bank Rate are expected to be gradual and to a lower level than in recent cycles.

4.5 In the August Quarterly Inflation Report, the Bank of England projected that GDP growth will continue around its average rate since 2013. Inflation is predicted to gradually increase to around 2% over the next 18 months and remain there in the near future. Further improvements in the labour market saw the unemployment rate falling to 5.5%, with average earnings rising.

4.6 However, there is uncertainty in growth which will be affected by international events:

- The outlook for business investment is tempered by the looming EU referendum;
- The continuing economic uncertainty in Greece;

- China's growth has slowed which will dampen activities in other countries where there are close economic ties.

4.7 The majority of the Council's borrowing is from the PWLB (Public Works Loans Board). Long-term borrowing rates are influenced by gilt yields. As the UK is considered a "safe haven" for surplus cash, this demand keeps gilt yields and therefore PWLB rates at historically low levels.

4.8 The expected long term trend for PWLB borrowing rates is for them to rise, though the extent of these rises will be affected by international uncertainties. Increasing investor confidence in economic recovery will encourage investors to switch from bonds to riskier equities, thereby increasing PWLB rates.

4.9 PWLB rates during the first half of the financial year were as follows:

	5 years	**10 years**	**20 years**	**50 years**
Average	2.32%	2.96%	3.51%	3.49%
Highest	2.55%	3.26%	3.79%	3.78%
Lowest	2.02%	2.60%	3.16%	3.21%

4.10 Estimates of future rates are as follows:

	Base Rate	**PWLB rates**			
		5 years	**10 years**	**20 years**	**50 years**
2015/16 (Act 6 mth Average)	0.5%	2.32%	2.96%	3.51%	3.49%
31/03/16	0.5%	2.55%	3.05%	3.50%	3.50%
31/03/17	1.0%	2.90%	3.40%	3.65%	3.70%

5.0 BORROWING ACTIVITY AND RESULTS

5.1 The borrowing strategy for 2015/16 approved by Council in March 2015 reported that the Group Director, Corporate and Frontline Services as Section 151 Officer (or in his absence the Deputy Section 151 Officer), under delegated powers, will take the most appropriate form of borrowing depending upon the prevailing interest rates at the time, and taking into account advice provided by our advisors.

5.2 In March, the borrowing requirement was estimated to be £15.1m based on the Capital Programme at that time. In line with changes to the Capital Programme, this year's borrowing requirement has increased to £25.9m. The increase in 2015/16 is mainly due to rephasing of some schemes and subsequent reprofiling of budgets, for example, in respect of the school modernisation projects.

5.3 It was also reported that the Council will monitor prevailing PWLB rates for any opportunities to reschedule debt to generate savings. I can report that to the 30th September this financial year, the Council has not had a viable option to reschedule debt. Affordability and the cost of carry remained important influences on the Council's borrowing strategy. As short term interest rates have remained lower than long term rates, the Council determined it was more cost effective in the short term to use internal resources and borrow short term. The Council has taken short term temporary borrowing in the first half of 2015/16 and based on cashflow projections, it is likely we will undertake more short term borrowing to meet cash shortfalls. However, this approach may change if longer term interest rates are at risk of increasing significantly. In this case, long term borrowing may be undertaken.

5.4 In line with the above strategy, this Council has not borrowed in advance of need during the first 6 months of the year and has no current intention to borrow in advance during the remainder of 2015/16.

5.5 No variance is currently being projected for net capital charges which have a budget for 2015/16 of £23.4m. This is being achieved despite the challenges faced with investment income and maintaining our low risk strategy.

6.0 CERTAINTY RATE

6.1 Three years ago HM Treasury introduced "the certainty rate", whereby local authorities were able to access borrowing at 0.2% cheaper than published PWLB rates. This year again, authorities were required to provide an indication of their potential borrowing requirements for the next 3 years. This Council provided such information to HM Treasury and will continue to be able to access the discounted rate up to 31st October 2016.

7.0 ESTIMATED AND ACTUAL TREASURY POSITION AND PRUDENTIAL INDICATORS

7.1 During the six months to 30th September 2015, the Council operated within its prudential limits set out in the Prudential Code report approved by Council in March 2015. Details of limits and actual performance are as follows:

7.2 Capital Expenditure and the Capital Financing Requirement

7.2.1 The Capital Expenditure plans of the Council are primarily financed by capital receipts and capital grants. The remaining element which cannot be immediately financed from other resources will constitute our borrowing requirement. The estimated level of available capital resources is provided in summary as the Capital Expenditure Indicator below.

Indicator : Capital Expenditure

	2015/16 Projected Outturn £M	2015/16 Original Estimate £M	2016/17 Revised Estimate £M	2017/18 Revised Estimate £M
Supported spend	68.641	50.602	28.371	18.069
Unsupported spend	19.012	8.150	13.084	0.613
Total spend	87.653	58.752	41.455	18.682
Financed by:-				
Borrowing	25.946	15.084	20.018	7.547
Other Capital Resources (Grants, Capital Receipts)	61.707	43.668	21.437	11.135

7.2.2 The Capital Financing Requirement (CFR) represents the Council's underlying need to borrow for capital purposes. The CFR is capital expenditure that has not yet been paid for from either revenue or capital resources.

7.2.3 The Council's expectation for the CFR for the next three years is shown below.

Indicator : Capital Financing Requirement (CFR)

	31/03/16 Projected Outturn £M	2015/16 31/03/16 Original Estimate £M	2016/17 31/03/17 Revised Estimate £M	2017/18 31/03/18 Revised Estimate £M
CFR	397.520	395.090	402.176	394.509
Net movement in CFR			4.656	(7.667)

7.2.4 The expected external debt for each year is as detailed below.

Indicator : External Debt

	30/09/15 Actuals £M	2015/16 31/03/16 Original Estimate £M	2015/16 31/03/16 Revised Estimate £M	2016/17 31/03/17 Revised Estimate £M	2017/18 31/03/18 Revised Estimate £M
Borrowing	197.087	261.615	239.015	289.615	327.517
Other long term liabilities	24.862	26.420	25.225	23.982	22.689
Total External Debt	221.949	288.035	264.240	313.597	350.206

7.2.5 Long Term Liabilities include the Council's obligation under its PFI scheme and finance leases.

8.0 LIMITS TO BORROWING ACTIVITY

8.1 The first key control over the Council's activity is to ensure that, over the medium term, borrowing will only be for a capital purpose. The Council needs to ensure that external borrowing does not exceed the total of the capital financing requirement in the preceding year plus the estimate of the additional capital financing requirement for the next three financial years. This allows some flexibility within a three-year period to deliver an effective Treasury Management strategy.

Borrowing Activity (Gross Borrowing)

	30/09/15 Actuals £M	2015/16 31/03/16 Original Estimate £M	2015/16 31/03/16 Revised Estimate £M	2016/17 31/03/17 Revised Estimate £M	2017/18 31/03/18 Revised Estimate £M
Gross Borrowing (inc. Other Long Term Liabilities)	221.949	288.035	264.240	313.597	350.206
Capital Financing Requirement		395.090	397.520	402.176	394.509

8.2 The Authorised Limit represents the limit beyond which borrowing is prohibited, and needs to be set, monitored and revised by Members. It reflects the maximum level of borrowing to fund existing capital commitments, which could be afforded in the short term, but is not sustainable. It is the expected maximum borrowing need, with some added headroom for unexpected movements.

Indicator : The Authorised Limit

	2015/16 30/09/15 Actuals £M	2015/16 Limit £M	2016/17 Limit £M	2017/18 Limit £M
Gross Borrowing	197.087	369.000	371.000	366.000
Other long term liabilities	24.862	27.000	26.000	24.000
Authorised Limit	221.949	396.000	397.000	390.000

8.3 The Operational Boundary is based on the probable external debt during the course of the year; actual borrowing could vary around this boundary, for short times, during the year. It should act as an indicator to ensure the Authorised Limit is not breached.

Indicator : The Operational Boundary

	2015/16 30/09/15 Actuals £M	2015/16 Estimate £M	2016/17 Estimate £M	2017/18 Estimate £M
Gross Borrowing Limit	197.087	240.000	290.000	328.000
Other long term liabilities	24.862	25.000	24.000	23.000
Operational Boundary	221.949	265.000	314.000	351.000

9.0 AFFORDABILITY PRUDENTIAL INDICATORS

9.1 Previous sections have covered overall capital and control of borrowing indicators, but there is also a requirement to assess the affordability of capital investment plans. This provides an indication of the impact of the capital investment plans on the overall Council finances.

9.2 The Ratio of Financing Costs to Net Revenue Stream identifies the trend in the cost of capital (borrowing costs net of interest and investment income) against the "net revenue stream". The net revenue stream for the General Fund is the amount collectable from Council Tax payers added to the Council's Revenue Support Grant (RSG) and Non Domestic Rates (NDR). The key use of this indicator is to compare trends in the ratio of financing costs to the net revenue stream, over time.

Indicator : Ratio of Financing Costs to Net Revenue Stream

	2015/16 Original Estimate	2015/16 Revised Estimate	2016/17 Revised Estimate	2017/18 Revised Estimate
General Fund	5.35%	5.34%	5.74%	6.03%

9.3 The Code requires limits to be set for :

I. Upper limits on variable rate exposure – this indicator identifies a maximum limit for variable interest rates based upon the debt position net of investments.

II. Upper limits on fixed rate exposure – similar to the above indicator this covers a maximum limit on fixed interest rates.

Indicator : Interest Rate Exposure

	2015/16 Actuals as at 30/09/15	2015/16 Out-turn as at 30/09/15	2015/16 Limit	2016/17 Limit	2017/18 Limit
Borrowing					
Limits on fixed rates	100%	100%	55%-100%	55%-100%	55%-100%
Limits on variable rates	0%	0%	0%-45%	0%-45%	0%-45%
Investments					
Limits on fixed rates	0%	0%	0%-25%	0%-25%	0%-25%
Limits on variable rates	100%	100%	75%-100%	75%-100%	75%-100%
Net Borrowing					
Limits on fixed rates	103%	100%	55%-125%	55%-125%	55%-125%
Limits on variable rates	-3%	0%	-25%-45%	-25%-45%	-25%-45%

9.4 A LOBO is a financial instrument called a "Lender's Option Borrower's Option". It provides a lower rate of interest for the initial period and a higher rate for the rest of its term (reversionary period), albeit that the higher rate was comparable with interest rates prevailing at the time the loans were taken. At the end of the initial period and at six monthly intervals, the lender has the option to increase the interest rate payable. This provides the Council with the option to repay the loan if the terms are not acceptable. It is the view of our Treasury Management Advisors that it is unlikely the LOBO's will be called within this financial year.

9.5 The amount of LOBO debt held (£85.5m, 39%), has not changed in 2015/16. Although not a requirement of the Prudential Code, an internal limit of LOBO debt is set as follows:

	£M	% of Debt Portfolio
LOBO Limits	100	45

9.6 The maturity structure indicator sets gross limits to reduce the Council's exposure to large fixed rate sums falling due for refinancing annually. The Code of Practice requires LOBO's to be represented in the maturity structure at the next option date, hence the table below demonstrates a high maturity within 12 months.

Indicator : Maturity Structure

	2015/16 Actuals as at 30/09/15	Upper Limit	Lower Limit
Under 12 months	38.62%	60%	0%
12 months to 2 years	1.00%	60%	0%
2 years to 5 years	0%	60%	0%
5 years to 10 years	0.25%	70%	0%
10 years to 20 years	12.15%	90%	0%
20 years to 30 years	0%	90%	0%
30 years to 40 years	45.72%	90%	0%
40 years to 50 years	2.26%	90%	0%

9.7 In order to maximise investment returns there could be opportunities for sums to be invested for longer than one year. This would only be undertaken with a prudent view of the primary considerations of security and liquidity.

Indicator : Total principal funds invested for periods longer than 364 days

	Limit	31/03/16 Estimate
Maximum principal sums invested over 1 year	£15m	£1m

9.8 The funds invested with a maturity period of greater than 1 year is an operational investment (as opposed to a treasury investment) relating to the Local Authority Mortgage Scheme (LAMS) which Members approved during July 2012.

9.9 To date, during 2015/16, there have been no treasury investments with a maturity of greater than 1 year.

10.0 INVESTMENT STRATEGY, ACTIVITY & RESULTS

10.1 The Council manages its investments in-house, investing in line with the Council's approved lender criteria as approved by Council on the 25th March 2015.

10.2 The Financial Services (Banking Reform) Act 2013 gave the Bank of England powers to bail-in uninsured and unsecured creditors of a failing bank or building society. This means that banks on the verge of collapse could be forced to call upon their shareholders, bondholders and their biggest customers for cash before turning to taxpayers. As a result credit rating agencies have reviewed their ratings of such institutions and, despite reductions in government support, have seen upgrades due to an improvement in their underlying strength.

10.3 Members will recall that following the onset of the unprecedented national and international economic crisis in 2008, all of this Council's cash flows are currently being invested in the Debt Management Account Deposit Facility and other Government backed public sector bodies, in line with the aforementioned approved strategy. This strategy ensures we prioritise **S**ecurity (protecting monies invested), then **L**iquidity (cashflow) and finally **Y**ield (return on investment). The order of these "SLY" priorities are detailed in Investment Guidance produced by the Welsh Government.

10.4 I have kept this under constant review subsequently with a view to returning to market investment activity at an appropriate time. To date, the Council has not returned to market investments but has set up a number of AAA rated money market funds to provide further diversification options when the opportunity does arise. These accounts have not been used during 2015/16. Members will be kept informed of any changes as part of the Council's quarterly performance reports.

10.5 The following table shows the overall result of the investment activities undertaken by the Council:

	Interest Received £M	Average Cash Balance £M	Return on Investments %	Benchmark Return %
General Balances	0.033	8.63	0.39	0.36

The benchmark for Local Authority internally managed funds is the average 7-day LIBID rate.

10.6 Despite our low risk strategy our return on investments is above the benchmark return. The key contributory factor is the return on the £1m 5-year deposit with Lloyds in respect of the Local Authority Mortgage Scheme. Whilst the Economic Background section of this report states that UK growth is on an upward trend, the economy is experiencing continuing difficulties as this growth has been gradual and weak. As a result of these conditions, interest rates remain low.

10.7 With regard to the Council's investment (£3M) with the former Heritable Bank PLC, the administrators had previously stated that it was unlikely that creditors would receive any further material dividends (as reported to Council on the 23rd July 2014). However, notification was received from the administrators on the 1st September 2015 that a further dividend was to be paid amounting to £0.120M. This brings the overall sum returned to the Council to £2.949M.

11.0 LOCAL AUTHORITY MORTGAGE SCHEME (LAMS)

11.1 As approved by Council on 4th July 2012, the Council launched the Local Authority Mortgage Scheme during September 2012, which supports First Time Buyers in purchasing a home. The scheme is facilitated by Lloyds Bank and allows First Time buyers to access 95% loan to value mortgages on terms similar to 75% loan to value mortgages. The bank is able to offer such loans where the Council guarantees the loan up to 20% of the value of the property. It is a requirement of the scheme that the Council places a deposit with the bank for the length of the indemnity. Therefore the Council has a deposit of £1m with Lloyds for 5 years. The scheme is now closed with 70 loans given to first time buyers.

12.0 TREASURY MANAGEMENT ADVISORS

12.1 The Council appointed Arlingclose as its Treasury Management Advisors during March 2014 and they continue to support the Council's Treasury Management function.

13.0 TRAINING

13.1 On 19th March 2015, officers attended an investment workshop hosted by Arlingclose to give an overview of the economic environment, interest rate forecasts and associated implications for the Council. The Group Accountant for Financial Reporting attended an update workshop on the 2nd December 2015. In addition, 2 strategy meetings have been held between Arlingclose and officers this year. Officers continue to receive interest rate information, economic data and general market environment information on a regular basis.

14.0 MINIMUM REVENUE PROVISION (MRP)

14.1 In accordance with legislative requirements applicable to local government (Local Government Act 2003), there is a requirement to charge an amount to revenue each year in respect of capital expenditure that is funded by borrowing. This charge is known as Minimum Revenue Provision (MRP) and must be a prudent amount.

14.2 The method of charging MRP for Supported Borrowing is defined by regulations and this Council currently applies the 'regulatory method', that is, 4% on a reducing balance basis. With regard to PFI and Finance leases MRP is equivalent to the principal value of repayments. With regard to the method of charging MRP to Council Fund Balances in respect of Unsupported Borrowing only, then the method used is dependent upon the type of asset being created as set out in the approved MRP Policy statement.

15.0 CONCLUSION

15.1 The 2015/16 financial year continues to be a challenging year for Treasury Management and this report highlights for Members the Treasury Management activities that have been undertaken during the first half of this year.

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