

**RHONDDA CYNON TAF COUNTY BOROUGH COUNCIL**

**MUNICIPAL YEAR 2016-2017**

**COMMITTEE:  
FINANCE AND PERFORMANCE  
SCRUTINY COMMITTEE**

**19<sup>th</sup> September 2016**

**REPORT OF :**

**THE GROUP DIRECTOR, CORPORATE AND FRONTLINE SERVICES**

**Chris Lee (01443) 424026**

<b>AGENDA ITEM NO. 3</b>
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<b>2015/16 TREASURY MANAGEMENT REVIEW AND AMENDMENT TO THE 2016/17 INVESTMENT STRATEGY</b>
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**1.0 PURPOSE OF REPORT**

1.1 This report provides Members with the opportunity to scrutinise the Annual Treasury Management Review and amendment to the Investment Strategy for 2016/17 presented to Council on 20<sup>th</sup> July 2016 (Appendix 1).

**2.0 RECOMMENDATIONS**

It is recommended that Members:

2.1 Note the content of this report.

2.2 Scrutinise and comment on the information provided.

2.3 Consider whether they wish to receive further detail on any matters contained in the report.

**3.0 ANNUAL TREASURY MANAGEMENT REVIEW (Appendix 1)**

3.1 This report details the activities undertaken by the Treasury Management function during 2015/16.

3.2 I would like to highlight key points as follows:

- The Council has complied with all relevant Codes of Practice, regulations and guidance (para 3.3).
- Net Capital Charges for the year were within budget (para 7.3).
- Compliance has been achieved in terms of all Prudential and Treasury indicators (para 8.1).
- The Council continues to adopt a low risk strategy in terms of investing and borrowing (paras 9.2 - 9.3).

- An amendment to the Investment Strategy for 2016/17 (paras 12.1 – 12.7).

#### **4.0 CONCLUSION**

- 4.1 This report, together with Appendix 1 provides Members with the opportunity to scrutinise the 2015/16 activities of Treasury Management and the amendment to the Investment Strategy for 2016/17.

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**RHONDDA CYNON TAF COUNTY BOROUGH COUNCIL****MUNICIPAL YEAR 2016-2017 – REPORT NO.****COMMITTEE:  
COUNCIL**

20th July 2016

**REPORT OF :****THE GROUP DIRECTOR, CORPORATE AND FRONTLINE SERVICES  
Chris Lee (01443) 424026**

	<b>AGENDA ITEM NO.8</b>
<b>2015/16 ANNUAL TREASURY MANAGEMENT REVIEW AND AMENDMENT TO THE 2016/17 INVESTMENT STRATEGY</b>	

**1.0 PURPOSE OF REPORT**

1.1 This report constitutes the statutory requirement to provide Members with information on :-

- the Council's Treasury Management activity during 2015/16; and
- the actual Prudential and Treasury Indicators for 2015/16.

1.2 It also proposes an amendment to the Investment Strategy for 2016/17.

**2.0 RECOMMENDATIONS**

2.1 It is recommended that Members;

- note the content of this report, and
- approve the amendment to the Investment Strategy for 2016/17.

**3.0 INTRODUCTION**

3.1 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”.*

3.2 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. The Council is required to comply with both Codes through Regulations issued under the Local Government Act 2003.

3.3 The primary requirements of the Codes are as follows:

- Creation and maintenance of a Treasury Management Policy;
- Creation and maintenance of Treasury Management Practices, which set out the manner in which the Council will seek to achieve stated policies and objectives;
- Approval by Council (by 31<sup>st</sup> March) of a Treasury Management Strategy Report (including Prudential and Treasury Indicators and an Investment Strategy) for the year ahead, an Annual Review Report of the previous year and a Mid Year Review; and
- Effective scrutiny of the Treasury Management function.

Rhondda Cynon Taf C.B.C. complies with these requirements and supplements this by including detail of our treasury activities and prudential indicators in the quarterly Council performance reports to Members.

- 3.4 During 2015/16, the Finance and Performance Scrutiny Committee has continued to scrutinise the Treasury Management function via quarterly performance reports and reviews of the strategy and mid year position.
- 3.5 This annual report will cover the following areas of treasury activity during 2015/16 :
- Treasury Management advisors;
  - Economic background;
  - Borrowing strategy;
  - Borrowing activity and results;
  - The estimated and actual treasury position and prudential indicators;
  - Investment strategy;
  - Investment activity and results.
- 3.6 It should be noted that the accounting practice to be followed by the Council requires financial instruments in the accounts (debt, investments, etc) to be measured in a method compliant with International Financial Reporting Standards. The figures in this report are based on the principal amounts borrowed and invested and so may differ from those in the Council's Statement of Accounts.

#### **4.0 TREASURY MANAGEMENT ADVISORS**

- 4.1 The Council appointed Arlingclose as its Treasury Management Advisors during March 2014. The contract is for 3 years with an option to extend for up to a further 2 years.
- 4.2 To date the service provided has been good. The Council will continue to monitor advisors performance. If any adverse performance or contractual issues arise, Members will be informed accordingly.

- 4.3 The Council recognises that although information and advice is provided via the contract, responsibility for Treasury Management decisions remains with the Council.

## **5.0 ECONOMIC BACKGROUND**

### **5.1 General Economic Background to 2015/16**

- 5.1.1 The UK economy slowed in 2015 with GDP growth falling to 2.3% from 3.0% the year before. The prolonged spell of low inflation was attributed to the continued collapse in the price of oil and weaker than anticipated wage growth, though the labour market continued to improve through 2015.
- 5.1.2 Between February and March 2016 sterling had depreciated by around 3%. A significant proportion of the decline reflected the uncertainty surrounding the EU referendum result.
- 5.1.3 The Bank of England Monetary Policy Committee maintained interest rates at 0.5% and reiterated the fact that any increases in the Bank Rate would be gradual and slow.
- 5.1.4 The Council continued to maintain a low risk strategy throughout the year to ensure exposure to any capital loss was minimised.

### **5.2 Short term investment rates**

- 5.2.1 The Council's investment income is subject to changes in short term interest rates. The level of the 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 year as it has done since 2009.

### **5.3 Longer term interest rates**

- 5.3.1 The majority of the Council's borrowing is from the PWLB (Public Works Loans Board). Long-term borrowing rates are influenced by gilt yields which are driven by inflation and demand/supply considerations.
- 5.3.2 During August 2012, HM Treasury introduced "the certainty rate", whereby local authorities are able to access borrowing at 0.2% cheaper than published PWLB rates. In order to access the discounted rate, authorities were required to provide Welsh Government (and onward, the Debt Management Office) with an indication of their potential borrowing requirements for the next 3 years.

5.3.3 PWLB rates during 2015/16 were as follows (these are the “certainty rates”):

	<b>5 years</b>	<b>10 years</b>	<b>20 years</b>	<b>50 years</b>
Average	2.00%	2.65%	3.26%	3.22%
Highest	2.35%	3.06%	3.59%	3.58%
Lowest	1.47%	2.10%	2.86%	2.81%

## **6.0 BORROWING STRATEGY**

- 6.1 The borrowing strategy for 2015/16 approved by Council in March 2015 stated that the borrowing requirement to fund the 2015/16 Capital Programme was £15.1m. In line with the capital programme, the borrowing requirement increased to £16.6m during the year largely due to the approval of the 21<sup>st</sup> Century Schools schemes for Rhondda and Tonyrefail school modernisation. It was also reported that the cheapest form of borrowing would be “internal borrowing” by running down cash balances and foregoing interest earned at historically low rates. This also minimises counterparty risk (risk that an investment may become irrecoverable).
- 6.2 The strategy also reported that the Section 151 Officer, under delegated powers, would take the most appropriate form of borrowing depending upon the prevailing interest rates at the time, taking into account advice provided by our advisors.
- 6.3 Affordability and the cost of carry remained important influences on the Authority’s borrowing strategy alongside the consideration that for any borrowing undertaken ahead of need, the proceeds would have to be invested at rates of interest significantly lower than the cost of borrowing. As short term interest rates have remained, and are likely to remain lower than longer term rates, the authority determined it was more cost effective in the short term to utilise short term loans. The benefits of internal borrowing and short term borrowing were monitored regularly against the potential implications of deferring borrowing into future years and the timing of long term borrowing rates rising.
- 6.4 It was also reported that the Council may reschedule debt where there is an opportunity to generate savings. However, changes in PWLB rate calculations have reduced the attractiveness of early repayments associated with rescheduling.

## 7.0 **BORROWING ACTIVITY AND RESULTS**

7.1 A summary of the Council's borrowing activity (excludes PFI and Finance Leases) can be seen in the table below:

<b>£'M</b>	<b>Fixed Rate Debt</b>	<b>Market Debt</b>	<b>Variable Debt</b>	<b>Total</b>
Opening Bal 1 <sup>st</sup> April 2015	109.674	87.500	12.279	209.453
Repayments	(0.145)	0	(15.375)	(15.520)
New borrowing	0	0	3.531	3.531
Closing Bal 31 <sup>st</sup> March 2016	109.529	87.500	0.435	197.464

7.2 Short term loans were taken to meet day to day cashflow requirements at an average rate of 0.39%. In accordance with our low risk strategy as detailed in section 6 above, to minimise investment exposure and counterparty risk on cash balances held, no long term borrowing was undertaken during 2015/16.

7.3 During the year there was a net saving on the Council's Net Capital Charge Budget (£23.4m) of £0.660m. This has been achieved as a result of prudent and effective management of the Council's cash-flows (enabling delays to borrowing being taken), despite the challenges faced with investment income and maintaining our low risk strategy.

7.4 There were no opportunities to further reduce the cost of our borrowing via rescheduling during the year.

7.5 The results (interest payable) for the year can be summarised as follows:

	<b>Fixed Rate Debt</b>	<b>Market Debt</b>	<b>Variable Rate Debt</b>	<b>Total</b>
Total Interest £M	5.273	4.317	0.004	9.594
Average Debt £M	109.602	87.500	0.803	203.459
Average Interest %	4.81%	4.93%	0.50%	4.72%

7.6 Members will also recall the previously reported position with regard to the accounting arrangements and treatment of LOBO's (Lender Option / Borrower Option). These loan instruments have enabled the Council to realise significant short-term and further ongoing reductions in its capital charges. These savings have been invested into key service improvements and the Treasury Management Reserve, which have helped not only to reduce risk around future financial market changes, but also as pump priming to produce more efficient and effective on-going front line services for the taxpayer.

## 8.0 ESTIMATED AND ACTUAL TREASURY POSITION, PRUDENTIAL AND TREASURY INDICATORS

8.1 During the financial year 2015/16, the Council operated within its limits set out in the Prudential Code report approved in March 2015. Details of limits and actual performance are as follows:

		<b>2015/16 Actual £</b>
Capital Expenditure 15/16		66.877M
Capital Financing Requirement (CFR) as at 31 <sup>st</sup> March 2016		391.914M

<b>Limit / Indicator</b>	<b>2015/16 Limit / Indicator</b>	<b>2015/16 Actual</b>
Authorised Limit (£) (Limit beyond which borrowing is prohibited)	396.000M	221.618M (at highest point in year)
Operational Boundary (£) (Indicator to ensure Authorised Limit not breached)	290.000M	221.618M (at year end)
External Debt (£)	261.615M	197.015M
Other Long Term Liabilities	<u>0.900M</u>	<u>0.450M</u>
Sub total	262.515M	197.465M
Other : PFI and Finance Lease	<u>25.520M</u>	<u>24.153M</u>
Borrowing + Other Long Term Liabilities	288.035M	221.618M
Ratio of Financing Costs to Net Revenue Stream	5.35%	4.56%
Limit on Fixed Interest Rates	55% - 125%	117%
Limit on Variable Interest Rates	-25% - 45%	-17%
Funds invested for greater than 1 year (£)	15M	1M (refer to section 11)



LOBO Limit	£100M / 45% of debt portfolio	£85.5M / 37% of debt portfolio
Maturity Structure of Fixed Rate Debt	Under 12 mths 0-60% 12 mths – 2 yrs 0-60% 2-5 years 0-60% 5-10 years 0-70% 10-20 years 0-90% 20-30 years 0-90% 30-40 years 0-90% 40-50 years 0-90%	Under 12 mths 41% 12 mths – 2 yrs 0% 2-5 years 1% 5-10 years 0% 10-20 years 12% 20-30 years 0% 30-40 years 39% 40-50 years 7%

## 9.0 **INVESTMENT STRATEGY**

- 9.1 The Council manages its investments in-house, investing during 2015/16, in line with the Council's approved lender criteria as approved by Council on the 25<sup>th</sup> March 2015. Investment policy is governed by Welsh Government guidance.
- 9.2 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 low risk strategy was formed balancing risk and return. It is acknowledged that low risk investment strategies result in lower investment returns.
- 9.3 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.
- 9.4 During the year, the Council has complied with the approved strategy and there have been no liquidity difficulties.
- 9.5 During 2015/16, the Council has not invested funds for longer than 364 days (other than in respect of the Local Authority Mortgage Scheme as detailed below at paragraph 11).

## 10.0 **INVESTMENT ACTIVITY AND RESULTS**

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

	<b>Interest Received</b>	<b>Average Cash Balance</b>	<b>Return on Investments</b>	<b>Benchmark Return</b>
	<b>£M</b>	<b>£M</b>	<b>%</b>	<b>%</b>
Cash Balances	0.076	19.733	0.39	0.36

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

10.2 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 (see paragraph 11). The Economic Background section of this report set out the continuing difficulties in economic conditions during this period. As a result of these conditions and our low risk strategy, interest rates on investments remain low.

## 11.0 **LOCAL AUTHORITY MORTGAGE SCHEME (LAMS)**

11.1 During September 2012, the Council launched the Local Authority Mortgage Scheme 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.

## 12.0 **AMENDMENT TO INVESTMENT STRATEGY 2016/17**

12.1 In line with statutory requirements and the CIPFA Code of Practice on Treasury Management, Council approved the Investment Strategy for 2016/17 on 23<sup>rd</sup> March 2016. This continued with the previous strategy as outlined above in Section 9 of the report, of investing only with the Debt Management Office DMADF (Debt Management Account Deposit Facility) and other Government backed public sector bodies.

12.2 Since that date, further uncertainty has been introduced into markets as a consequence of the EU Referendum.

- 12.3 However, officers in conjunction with our Treasury Advisors have continued to explore opportunities for the Council to supplement its existing strategy with lending to organisations upon which we would undertake appropriate due diligence **and** put in place appropriate security arrangements. This could result in the Council being able to achieve better investment returns at an acceptable level of risk and to secure base budget savings over the short to medium term to protect frontline services.
- 12.4 To enable the Council to support the above, the Investment Strategy agreed by Council on the 23<sup>rd</sup> March would require amendment.
- 12.5 Such transactions are termed “Non Specified Investments”. These are investments that do not meet all the criteria of “Specified Investments”. The criteria for Specified Investments are:
- The investment is denominated in sterling
  - It is not long term
  - It is not capital expenditure
  - It is of high credit quality
- 12.6 Investment decisions in these “Non Specified Investments” will be subject to S151 officer determination, following appropriate due diligence and subject to appropriate and acceptable security arrangements being put in place as part of the commercial agreement.
- 12.7 It is proposed that a maximum exposure for this type of investment would be set at £10M with a maximum maturity limit of 10 years.

### **13.0 CONCLUSION**

- 13.1 The last financial year has continued to be extremely challenging in relation to Treasury Management and this report highlights for Members that all related activities have operated effectively and within budgetary and prudential limits.
- 13.2 Approval is also sought for an amendment to the 2016/17 Investment Strategy.

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