Report to	Council	**Item**
	27 September 2016	
Report of	Chief finance officer	7
Subject	Treasury Management Full Year Review Report 2015-16	

Purpose

This report sets out the Treasury Management performance for the year to 31 March 2016

Recommendation

To note the report and the treasury activity for the year to 31 March 2016

Financial implications

The report has no direct financial consequences however it does report on the performance of the council in managing its borrowing and investment resources

Ward/s: All Wards

Cabinet member: Councillor Stonard – Resources and business liaison

Contact officers

Justine Hartley	01603 212440
Philippa Dransfield	01603 212562

Report

1. Background

The council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering maximising investment return. Counterparty risk is the term for the potential risks taken by an investor that the bank, building society, local authority or investment counterparty will be unable to repay the money invested.

The second main function of the treasury management service is the funding of the council's capital plans. These capital plans provide a guide to the borrowing need of the council, essentially the longer term cash flow planning to ensure the council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet council risk or cost objectives.

As a consequence treasury management is defined as:

> "The management of the local authority'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."

2. Introduction

The council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2015-16. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

During 2015-16 the minimum reporting requirements were that the council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 17/02/2015)
- a mid year (minimum) treasury update report (Cabinet 09/12/2015)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is therefore important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the council's policies previously approved by members.

This council also confirms that it has complied with the requirement under the Code to give prior scrutiny to treasury management reports by the cabinet before they were reported to the full council. Member training on treasury management issues was undertaken during June 2015 in order to support members' scrutiny role.

This report summarises the following:-

- Capital activity during the year (section 3)
- Impact of this activity on the council's underlying indebtedness (the Capital Financing Requirement) (section 4)
- The actual prudential and treasury indicators (section 4)

- Overall treasury position identifying how the council has borrowed in relation to this indebtedness, and the impact on investment balances (section 5)
- Review of treasury strategy and economic factors (sections 6 & 7)
- Borrowing rates and detailed debt activity (sections 8 & 9)
- Investment rates and detailed investment activity (sections 10 & 11)

3. The council's capital expenditure and financing 2015-16

The council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or
- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need, which will be satisfied by either external or internal borrowing.

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

£m General Fund	2014/15 Actual	2015/16 Mid-Year Estimate	2015/16 Actual
Capital expenditure	8.3	21.6	15.5
Financed in year	7.2	9.5	9.3
(Over) / unfinanced capital expenditure	1.1	12.1	6.3
£m HRA	**2014/15 Actual**	**2015/16 Mid-Year Estimate**	**2015/16 Actual**
Capital expenditure	30.5	42.9	36.6
Financed in year	32.0	42.9	37.0
(Over) / unfinanced capital expenditure	(1.5)	-	(0.5)

4. The Council's overall borrowing need

The council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the council's debt position. The CFR results from the capital activity of the council and what resources have been used to pay for the capital spend. It represents the 2015-16 unfinanced capital expenditure (see above table), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

Part of the council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the council's cash position to ensure sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the Government, through the Public Works Loan Board [PWLB] or the money markets), or utilising temporary cash resources within the council.

Reducing the CFR – the council's (non HRA) underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The council is required to make an annual revenue charge, called the Minimum Revenue Provision – MRP, to reduce the CFR. This is effectively a repayment of the non-Housing Revenue Account (HRA) borrowing need (there is no statutory requirement to reduce the HRA CFR). This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

The total CFR can also be reduced by:

- the application of additional capital financing resources (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

The council's CFR for the year is shown below, and represents a key prudential indicator. It includes PFI and leasing schemes on the balance sheet, which increase the council's borrowing need. No borrowing is actually required against these schemes as a borrowing facility is included in the contract.

£m General Fund	2014/15 Actual	2015/16 Mid-Year Estimate	2015/16 Actual
Opening balance	25.9	26.0	26.0
Add: Unfinanced capital expenditure (as above)	1.1	12.1	6.3
Less: MRP	(1.0)	(1.0)	-
Closing balance	26.0	37.1	32.3
£m HRA	**2014/15 Actual**	**2015/16 Mid-Year Estimate**	**2015/16 Actual**
Opening balance	208.8	207.3	207.3
Add: Unfinanced capital expenditure (as above)	(1.5)	(0.7)	(0.5)
Less: Finance lease repayments	(0.0)	0.0	(0.0)
Closing balance	207.3	206.6	206.8

Borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit.

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term the council's external borrowing, must only be for a capital purpose. This essentially means that the council is not borrowing to support revenue expenditure. Gross borrowing should not therefore, except in the short term, have exceeded the CFR for 2015-16 plus the expected changes to the CFR over 2015-16 and 2016-17 from financing the capital programme. This indicator allows the council some flexibility to borrow in advance of its immediate capital needs in 2015-16. The table below highlights the council's gross borrowing position against the CFR. The council has complied with this prudential indicator.

£m	2014/15 Actual	2015/16 Mid-Year Estimate	2015/16 Actual
Gross borrowing	224.2	224.5	224.2
CFR	233.3	243.7	239.1

The authorised limit - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. The council does not have the power to borrow above this level. The table below demonstrates that during 2015/16 the council has maintained gross borrowing within its authorised limit.

The operational boundary – the operational boundary is the expected borrowing position of the council during the year. Periods where the actual position is either below or over the boundary is acceptable subject to the authorised limit not being breached.

Actual financing costs as a proportion of net revenue stream - this indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

£m	2015/16
Authorised Limit	274.5
Maximum gross borrowing position	234.5
Operational boundary	234.5
Average gross borrowing position	221.6
Financing costs as a proportion of net revenue stream	5.12%

5. Treasury Position as at 31 March 2016

The council's debt and investment position is organised by the treasury management service in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through member reporting detailed in the summary, and through officer activity detailed in the council's Treasury Management Practices. At the beginning and the end of 2015-16 the council's treasury (excluding borrowing by PFI and finance leases) position was as follows:

	31- Mar-16 £m	Rate / Return	Average Life years	31- Mar-15 £m	Rate / Return	Average Life years
Fixed Rate Funding						
- PWLB	215.0	4.37%	9.5	218.9	4.42%	10.3
- Market	5.4	4.80%	38.04	5.0	4.80%	39.04
- Other	0.5	3.00%	Perpetually irredeemable	0.5	3.00%	Perpetually irredeemable
Total debt	220.9			224.4		
CFR	239.1			233.3		
Over /(under) borrowing	(18.2)			(8.9)		
Investments	58.3	0.82%	0.4	67.3	0.83%	0.5
Net Debt	162.6			157.2		

The maturity structure of the debt portfolio was as follows:

Maturity structure of fixed rate borrowing	31-Mar-2016 £m	31-Mar-2015 £m
under 12 months	10.75	6.36
12 months and within 24 months	2.00	5.75
24 months and within 5 years	7.00	14.00
5 years and within 10 years	113.16	59.96
10 years and within 20 years	76.83	132.18
20 years and within 30 years	4.12	1.97
30 years and within 40 years	5.29	5.29
Total	**219.15**	**225.51**

The difference between the amounts in the table above and the total debt disclosed in the previous table is the current repayable debt of £1.9m, of which £1.4m relates to accrued interest on the PWLB & Barclays loans and £0.5m is perpetually irredeemable 3% loan stock.

The following table shows the movement in investments in the year.

Investments £'000	Actual 31 March 2015	Movement			Actual 31 March 2016
		Invested	Matured	Transferred to Short Term	
Long Term					
Banks	3,000,000	-	-	-	3,000,000
Short term					
Banks	15,000,000	11,000,000	(16,000,000)	-	10,000,000
Building Societies	30,000,000	37,700,000	(42,700,000)		25,000,000
Local Authorities	5,000,000	-	(5,000,000)		-
Cash Equivalents					
Banks	10,000,000	130,511,219	(130,511,219)		10,000,000
Building Societies	4,250,000	331,485,423	(333,435,423)		2,300,000
Local Authorities	-	8,000,000	-		8,000,000
Total	**67,250,000**	**518,696,642**	**(527,646,642)**	**-**	**58,300,000**

The maturity structure of the investment portfolio was as follows:

£'000	31-Mar-16	31-Mar-15
Longer than 1 year	3,000	3,000
Under 1 year	55,300	64,250
	58,300	**67,250**

6. The Strategy for 2015-16

The expectation for interest rates within the treasury management strategy for 2015/16 anticipated low but rising Bank Rate, (starting in quarter 1 of 2016), and gradual rises in medium and longer term fixed borrowing rates during 2016/17. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period. Continued uncertainty in the aftermath of the 2008 financial crisis promoted a cautious approach, whereby investments would continue to be dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

In this scenario, the treasury strategy was to postpone borrowing to avoid the cost of holding higher levels of investments and to reduce counterparty risk.

The actual movement in gilt yields meant that the general trend in PWLB rates during 2015/16 was an increase in rates during the first quarter followed by marked bouts of sharp volatility since July 2015 but with an overall dominant trend for rates to fall to historically low levels by the end of the year.

7. The Economy and Interest Rates

Market expectations for the first increase in Bank Rate moved considerably during 2015/16, starting at quarter 3 2015 but soon moving back to quarter 1 2016. However, by the end of the year, market expectations had moved back radically to quarter 2 2018 due to many fears including concerns that China's economic growth could be heading towards a hard landing; the potential destabilisation of some emerging market countries particularly exposed to the Chinese economic slowdown; and the continuation of the collapse in oil prices during 2015 together with continuing Eurozone growth uncertainties.

These concerns have caused sharp market volatility in equity prices during the year with corresponding impacts on bond prices and bond yields due to safe haven flows. The Bank Rate, therefore, remained unchanged at 0.5% for the seventh successive year. Economic growth (GDP) in the UK surged strongly during both 2013/14 and 2014/15 to make the UK the top performing advanced economy in 2014. However, 2015 has been disappointing with growth falling steadily from an annual rate of 2.9% in quarter 1 2015 to 2.1% in quarter 4.

The Funding for Lending Scheme, announced in July 2012, resulted in a flood of cheap credit being made available to banks which then resulted in money market investment rates falling materially. These rates continued at very low levels during 2015/16.

The sharp volatility in equity markets during the year was reflected in sharp volatility in bond yields. However, the overall dominant trend in bond yields since July 2015 has been for yields to fall to historically low levels as forecasts for inflation have repeatedly been revised downwards and expectations of increases in central rates have been pushed back. In addition, a notable trend in the year was that several central banks introduced negative interest rates as a measure to stimulate the creation of credit and hence economic growth.

The ECB had announced in January 2015 that it would undertake a full blown quantitative easing programme of purchases of Eurozone government and other bonds starting in March at €60bn per month. This put downward pressure on Eurozone bond yields. There was a further increase in this programme of QE in December 2015. The anti-austerity government in Greece, elected in January 2015 eventually agreed to implement an acceptable programme of cuts to meet EU demands after causing major fears of a breakup of the Eurozone. Nevertheless, there are continuing concerns that a Greek exit has only been delayed.

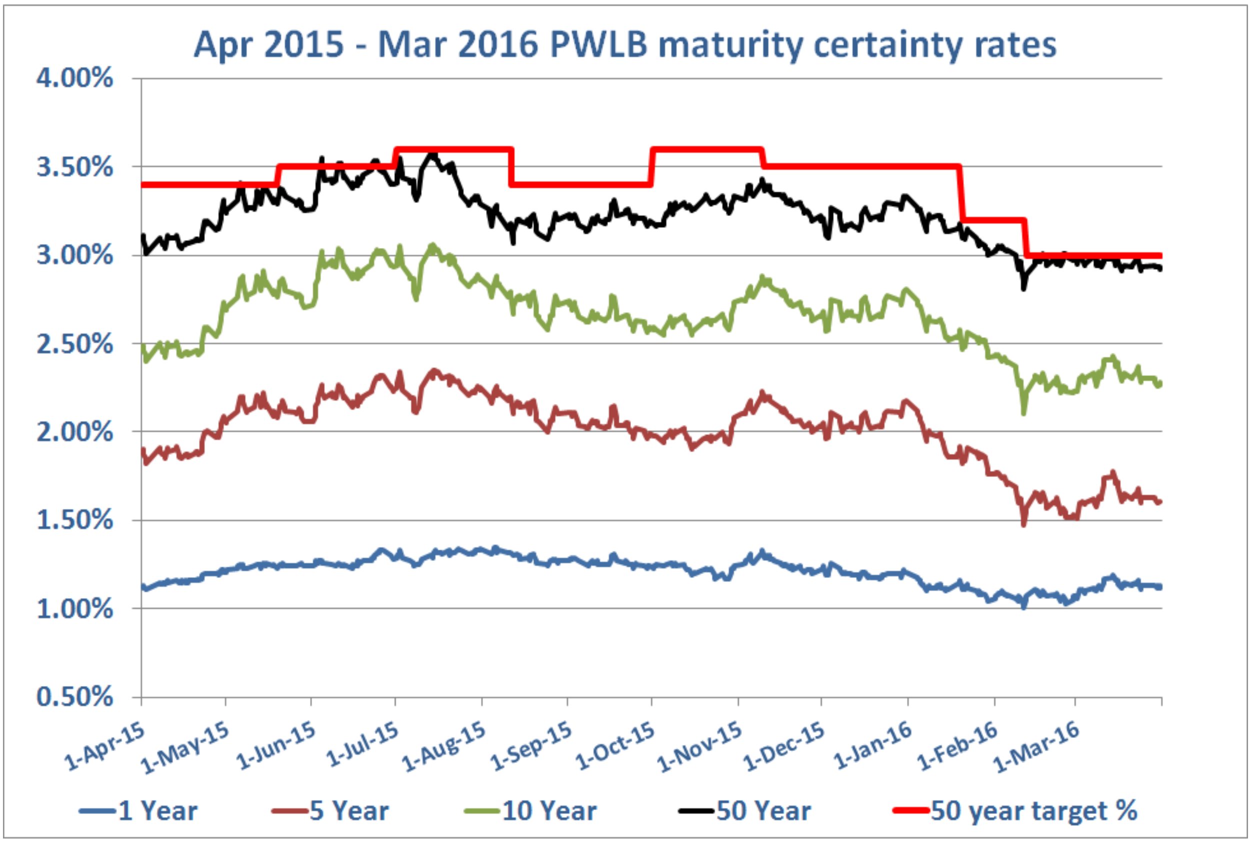
As for America, the economy has continued to grow healthily on the back of resilient consumer demand. The first increase in the central rate occurred in December 2015 since when there has been a return to caution as to the speed of further increases due to concerns around the risks to world growth.

On the international scene, concerns have increased about the slowing of the Chinese economy and also its potential vulnerability to both the bursting of a property bubble and major exposure of its banking system to bad debts. The Japanese economy has also suffered disappointing growth in this financial year despite a huge programme of quantitative easing, while two of the major emerging market economies, Russia and Brazil, are in recession. The situations in Ukraine, and in the Middle East with ISIS, have also contributed to volatility.

The UK elected a majority Conservative Government in May 2015, removing one potential concern but introducing another due to the promise of a referendum on the UK remaining part of the EU. The government maintained its tight fiscal policy stance but the more recent downturn in expectations for economic growth has made it more difficult to return the public sector net borrowing to a balanced annual position within the period of this parliament.

8. Borrowing Rates in 2015-16

PWLB borrowing rates - the graphs and table for PWLB maturity rates below show for a selection of maturity periods, the high and low points in rates, the average rates, spreads and individual rates at the start and the end of the financial year.



Borrowing Outturn for 2015-16

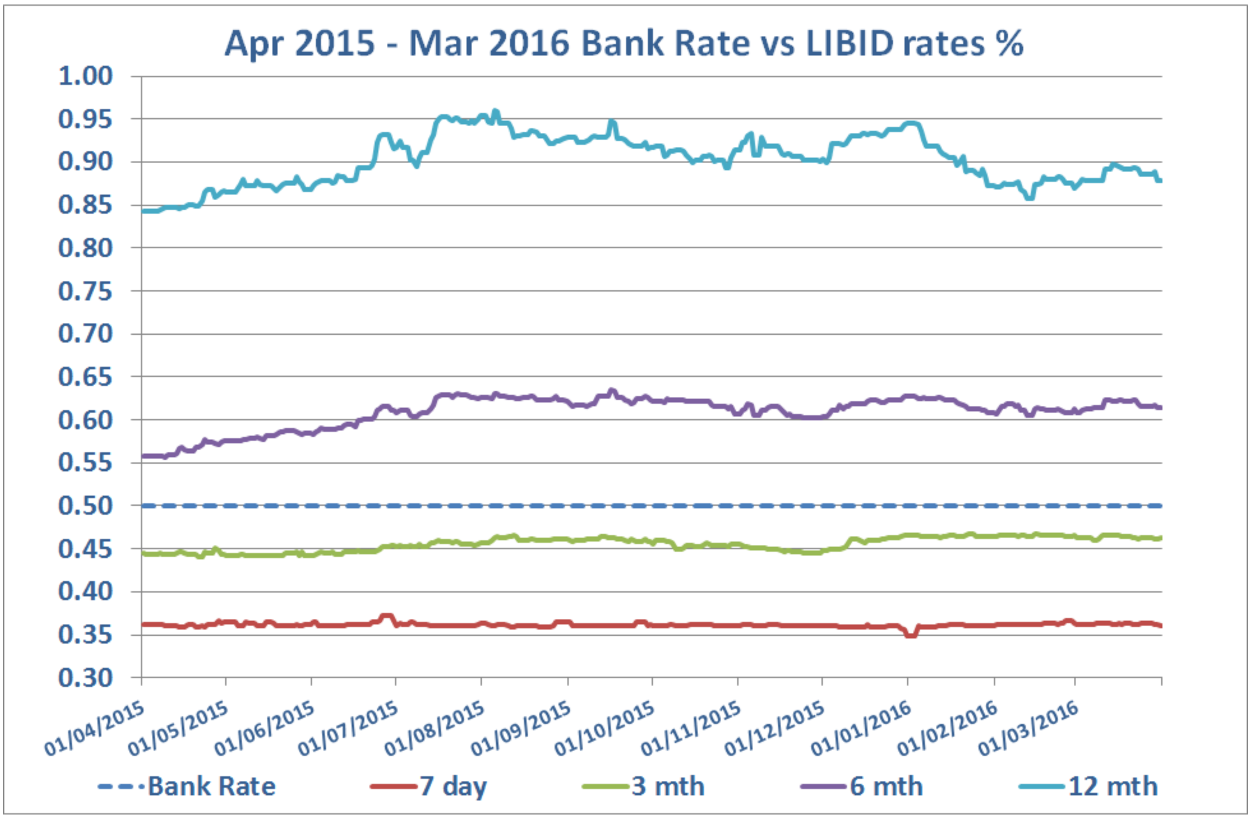
Due to investment concerns, both counterparty risk and low investment returns, no borrowing was undertaken during the year. However during 2015-16 £5.06m of PWLB debt was repaid.

Borrowings by the Council

During 2015-16 the council paid £9.78m in interest cost, this compares to a budget assumption of £9.70m

Investment Rates in 2015-16

Bank Rate remained at its historic low of 0.5% throughout the year; it has now remained unchanged for seven years. Market expectations as to the timing of the start of monetary tightening started the year at quarter 1 2016 but then moved back to around quarter 2 2018 by the end of the year. Deposit rates remained depressed during the whole of the year, primarily due to the effects of the Funding for Lending Scheme and due to the continuing weak expectations as to when Bank Rate would start rising.



9. Investment Outturn for 2015-16

Investment Policy – the council's investment policy is governed by CLG guidance, which was implemented in the annual investment strategy approved by the council on 17 February 2015. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies supplemented by additional market data (such as rating outlooks, credit default swaps [a financial swap agreement that the seller of the CDS will compensate the buyer in the event of a loan default or other credit event]., bank share prices etc.).

The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

Resources – the council's cash balances comprise revenue and capital resources and cash flow monies. The council's core cash resources comprised as follows:

£m Balance Sheet Resources	**31-Mar-16**	**31-Mar-15**
Balances	38.3	29.8
Earmarked Reserves	3.9	4.1
Useable Capital receipts	17.3	24.9
Capital grants Unapplied	3.2	5.1
Total	**62.7**	**63.9**

Investments held by the council - the council maintained an average balance of £74.6m of internally managed funds. The internally managed funds earned an average rate of return of 0.82%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.361%. This compares with a budget assumption of £77.6m investment balances earning an average rate of 1.0%. The average of the population of 206 local authorities was 0.70% and that of 87 non-met authorities was 0.72%.

The council's investment return for 2015-16 is £1,027,445 which is £427,445 above the amount budgeted for the year of £600,000. The variance is due to having a higher average balance to invest.

The council is part of a benchmarking group across Norfolk, Suffolk & Cambridgeshire, the table below shows the performance of the council's investments compared to the other councils (who have been made anonymous). This shows that the rate of return achieved by investments held at the year end by the council as being the 5th highest and with the 6th highest risk when compared to the rest of the benchmarking group.

Council	**WARoR**		**WA Risk**		**WAM**		**WA Tot. time**	
	31-Mar-16	**31-Mar-15**	**31-Mar-16**	**31-Mar-15**	**31-Mar-16**	**31-Mar-15**	**31-Mar-16**	**31-Mar-15**
Norwich	0.85%	0.83%	5.2	4.7	126	173	274	329
A	1.07%	0.90%	3.2	2.9	240	216	503	419
B	0.60%	0.51%	3.4	2.6	205	51	326	80
C	0.90%	0.75%	5.5	3.5	84	27	232	218
D	0.92%	0.78%	5.7	3.9	169	114	301	217
E	0.84%	0.68%	5.7	3.5	179	136	267	204
F	0.84%	0.75%	5.7	4.0	116	92	275	172
G	0.81%	0.79%	4.1	3.2	205	201	326	281
H	0.98%	0.89%	5.4	4.3	41	54	261	216

WARoR – Weighted average rate of return. This is the average annualised rate of return weighted by the principle amount in each rate

WA risk – Weighted average risk number. Each institution is assigned a colour to a suggested duration using Sector's credit methodology. The institution is assigned a number based on its colour and an average, weighted using principal amount, of these numbers is calculated.

1 Up to 5 years

2 Up to 2 years

3 Up to 1 year

4 Up to 6 months

5 Up to 3 months

6 0 months

A number of 4.7 means between 3 to 6 months

WAM – Weighted average time to maturity. This is the average time, in days, until the portfolio matures, weighted by the principle amount

WA Tot. Time – Weighted average total time. This is the average time, in days, that deposits are lent out for, weighted by the principle amount

Integrated impact assessment

NORWICH City Council

Report author to complete	
Committee:	Council
Committee date:	27 September 2016
Head of service:	Justine Hartley
Report subject:	Full Year Treasury Management Report
Date assessed:	31 August 2016
Description:	This is the integrated impact assessment for the Full Year Treasury Management Report to council for 2015-16

	Impact			
Economic **(please add an 'x' as appropriate)**	**Neutral**	**Positive**	**Negative**	**Comments**
Finance (value for money)	☐	☒	☐	The report has no direct financial consequences however it does report on the performance of the council in managing its borrowing and investment resources
Other departments and services e.g. office facilities, customer contact	☒	☐	☐	
ICT services	☒	☐	☐	
Economic development	☒	☐	☐	
Financial inclusion	☒	☐	☐	
Social **(please add an 'x' as appropriate)**	**Neutral**	**Positive**	**Negative**	**Comments**
Safeguarding children and adults	☒	☐	☐	
S17 crime and disorder act 1998	☒	☐	☐	
Human Rights Act 1998	☒	☐	☐	
Health and well being	☒	☐	☐	

	Impact			
Equality and diversity (please add an ‘x’ as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Relations between groups (cohesion)	☒	☐	☐	
Eliminating discrimination & harassment	☒	☐	☐	
Advancing equality of opportunity	☒	☐	☐	
Environmental (please add an ‘x’ as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Transportation	☒	☐	☐	
Natural and built environment	☒	☐	☐	
Waste minimisation & resource use	☒	☐	☐	
Pollution	☒	☐	☐	
Sustainable procurement	☒	☐	☐	
Energy and climate change	☒	☐	☐	
(Please add an ‘x’ as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Risk management	☒	☐	☐	

Recommendations from impact assessment
Positive
Negative
Neutral
Issues