ANNEX A

TREASURY MANAGEMENT UPDATE
QUARTER 2 (JULY-SEPTEMBER), 2015/16

Purpose:

The Chartered Institute of Public Finance and Accountancy (CIPFA) issued the revised Code of Practice for Treasury Management in November 2009; it recommends that Councillors should be updated on treasury management activities at least twice a year, but preferably quarterly. This report therefore ensures this council is implementing best practice in accordance with the Code.

Economic climate:

In summary, the third quarter of 2015 (calendar year) saw:

- UK economy slowdown continued, although business investment has picked up despite uncertainties in global economy and EU referendum looming;
- Global GDP concerns remain, particularly in light of prospects for Greece and the slowdown of China’s economic growth;
- Inflation pressure remains low;
- Unemployment levels fell to 5.5%. Labour market showed continued wages growth;
- The Monetary Policy Committee maintained the stance of monetary policy.

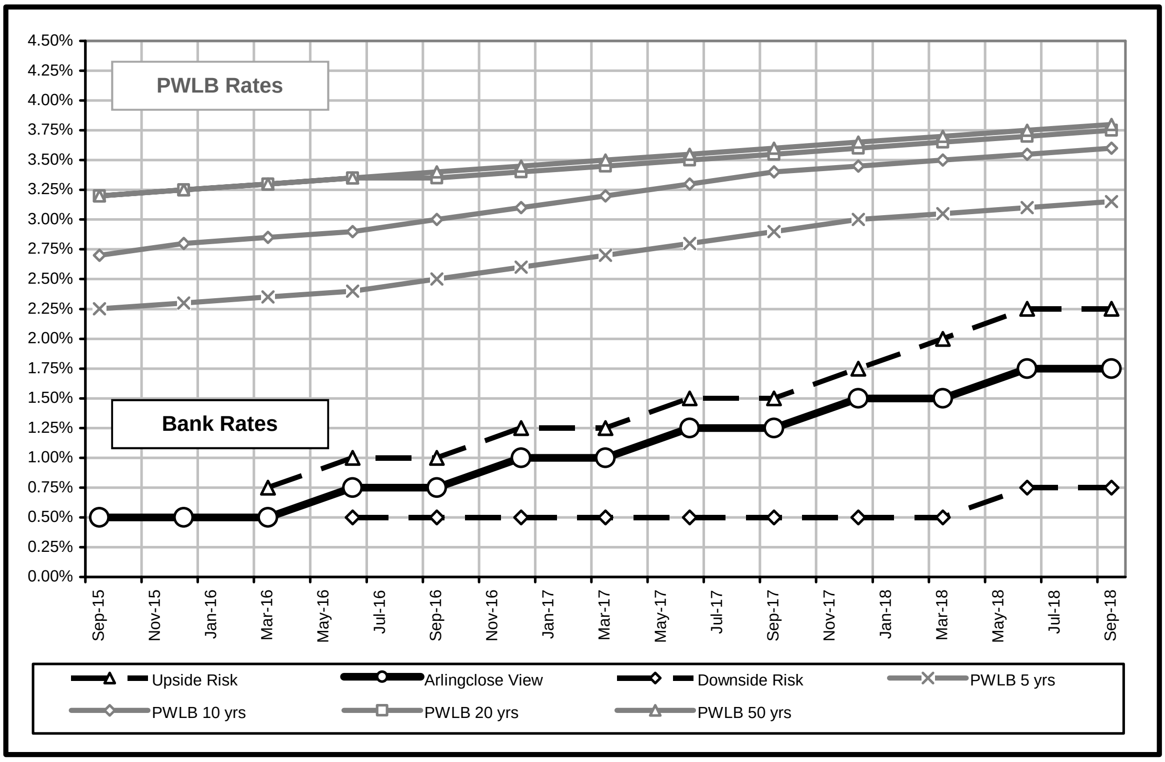
Interest rate forecast:

The latest forecast for interest rates of treasury advisors Arlingclose over the next three years is set out below, along with a sensitivity analysis of potential upside and downside risk to official bank rate.

Table 1: Interest Rate Forecast

	Sept 2015	Dec 2015	Mar 2016	Jun 2016	Sept 2016	Dec 2016	Mar 2017	Jun 2017	Sept 2017	Dec 2017	Mar 2018	Jun 2018	Sept 2018
Official Bank Rate													
Upside Risk			0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.50%
Arlingclose View	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%
Downside Risk				(0.25%)	(0.25%)	(0.50%)	(0.50%)	(0.75%)	(0.75%)	(1.00%)	(1.00%)	(1.00%)	(1.00%)
Public Works Loans Board Implied Rates (Certainty Rate)													
5 years	2.25%	2.30%	2.35%	2.40%	2.50%	2.60%	2.70%	2.80%	2.90%	3.00%	3.05%	3.10%	3.15%
10 years	2.70%	2.80%	2.85%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.45%	3.50%	3.55%	3.60%
20 years	3.20%	3.25%	3.30%	3.35%	3.35%	3.40%	3.45%	3.50%	3.55%	3.60%	3.65%	3.70%	3.75%
50 years	3.20%	3.25%	3.30%	3.35%	3.40%	3.45%	3.50%	3.55%	3.60%	3.65%	3.70%	3.75%	3.80%

Chart 1: Interest Rate Forecast



There are many risks to the forecast set out above, principally around the timing and pace of rate rises. Budget estimates prudently include sensitivity analysis of the impact that a slower than forecast economic recovery would have upon the Council.

Annual Investment Strategy

The Treasury Management Strategy Statement (TMSS) for 2015/16, which includes the Annual Investment Strategy, was approved by the Council on 18th February 2015. It sets out the Council's investment priorities as being:

1. **S**ecurity of Capital;
2. **L**iquidity; and
3. **Y**ield

The Council will also aim to achieve the optimum return (yield) on investments commensurate with proper levels of security and liquidity.

The table below summarises the forecast investment maturity position at 30th September 2015.

Table 2: Forecast Investment Maturity Position at 30th September 2015

Period	Product type / Maturity	Amount	
		£	**%**
Instant Access	Banks	£7,009,112	2.6
	Money Market Funds	£56,290,000	20.5
		£63,299,112	**23.1**
Fixed Term – Building Societies	6-9 months to maturity	**£1,000,000**	**0.4**
Fixed Term - Local Authorities	0-3 months to maturity	£15,000,000	5.5
	6-9 months to maturity	£20,000,000	7.3
	>12 months to maturity	£22,500,000	8.2
		£57,500,000	**21.0**
Certificates of Deposit – Banks	0-3 months to maturity	£88,500,000	32.4
	3-6 months to maturity	£33,800,000	12.4
	9-12 months to maturity	£4,200,000	1.5
		£126,500,000	**46.3**
Fixed Bonds – Banks	0-3 months to maturity	**£4,535,926**	**1.7**
Covered Bonds – Fixed Rate	2-3 years to maturity	**£5,757,550**	**2.1**
Covered Bonds – Floating Rate	2-3 years to maturity	**£5,004,462**	**1.8**
Property Fund	4-5 years to maturity*	**£9,818,617****	**3.6**
Total Investment Portfolio		**£273,415,667**	**100.0**

* In order to recoup initial BID/OFFER pricing spread. Monthly valuation dates for purchase/sale of units - redemptions may be delayed should the fund be required to raise cash meet this commitment.

** Forecast book value of investment

Investment rates available in the market continue to be low. Investment balances at the 31st March 2015 were £258.826m. Due to the front-loaded nature of various government funding streams the average level of funds available for investment purposes during this quarter is forecast at £297.484m (£294.967m year to date).

Balances are forecast to fall to circa £250.0m by 31st March 2016 as internal resources are applied to fund capital expenditure demands in lieu of further borrowing, effectively reducing the cost of carrying debt at higher cost than income generated through investment of balances.

Table 3: Forecast Benchmark Performance – Q2

Benchmark	Benchmark Return	Council Performance
3 month LIBID	0.53%	0.80%

As illustrated, the authority outperformed the benchmark by 27 basis points. Latest projections for the financial year are reported through the Budget Monitoring process.

New Borrowing

No new borrowing for capital purposes was undertaken during the quarter, with one existing PWLB loan of £2.5m repaid upon maturity (£9.150m principal repayments year to date).

Below is a table setting out the profile of existing borrowing as at 30th September 2015.

Table 4: Borrowing Profile as at 30th September 2015

	No of loan repayments *	Borrowing £m	%
Under 12 months	5	19.428	3.92
1-2 years	2	2.520	0.51
2-5 years	12	25.257	5.09
5-10 years	23	56.702	11.43
Over 10 years	63	392.274	79.05
		496.181	**100.00**

* 67 individual loans (57 principal repayments upon maturity, 10 annuity loans with bi-annual principal repayments)

Debt Restructuring

Debt rescheduling opportunities have been limited due to the current economic climate and consequent structure of interest rates following increases in PWLB new borrowing rates in October 2010. Officers continue to monitor the position regularly.

No debt rescheduling was undertaken during the quarter.

Compliance with Treasury and Prudential Limits

It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. The Council's approved Treasury and Prudential Indicators (affordability limits) were approved alongside the TMSS on 18th February 2015.

During the financial year to date the Council has operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Management Strategy Statement.

The Prudential and Treasury Indicators are shown in table 5 below:

Table 5: Forecast Treasury and Prudential Indicators as at 30th September 2015

Prudential Indicator	2015/16 Indicator	Quarter 2 – Forecast
Authorised limit for external debt	----- £591.000m -----	
Operational boundary for external debt	----- £571.000m -----	
Gross borrowing	£524.146m	£496.181m
Investments (quarter average)	£250.000m	£297.484m
Net borrowing	£274.146m	£198.697m
Capital Financing Requirement (CFR)	£541.727	£550.801m
Ratio of financing costs to net revenue streams: GF	11.17%	11.14%
HRA	41.14%	41.14%
Incremental impact of capital investment decisions:-		
a) Increase in council tax (band D) per annum.	(£0.01p)	£1.13p
b) Increase in average housing rent per week	£0.00p	£0.00p
Limit of fixed interest rates based on net debt (average)	£561.000m	£286.886m
Limit of variable interest rates based on net debt (average)	£30.000m	-£88.189m
Principal sums invested > 364 days	£200.000m	£43.081m
Maturity structure of borrowing limits:-		
Under 12 months	Max. 15% Min. 0%	3.92%
12 months to 2 years	Max. 15% Min. 0%	0.51%
2 years to 5 years	Max. 50% Min. 0%	5.09%
5 years to 10 years	Max. 50% Min. 0%	11.43%
10 years and above	Max. 100% Min. 50%	79.05%

Amendment to the Minimum Revenue Provision (MRP) Policy

Officers continually review treasury management practices and as a result have identified an opportunity to make the Council’s provision for repayment of historic debt liability more prudent.

Regulations 27 and 28 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (SI 3146, as amended) require local authorities to make a prudent amount of minimum revenue provision (MRP) for the repayment of debt. The Secretary of State has issued statutory guidance on determining the prudent level of MRP. While councils are required to have regard to the guidance, they are allowed to set their own policy outside of the options given if it can be demonstrated that this would be prudent.

The statutory guidance states that the broad aim of a ‘prudent provision’ is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or in the case of borrowing supported by revenue support grant, reasonably implicit in the determination of that grant.

The regulations separately identify the supported capital expenditure incurred before 1st April 2008 - to which this proposed change in MRP policy will apply - and the self-financed borrowing that was incurred after this time (it is not recommended that any changes are made to the MRP policy regarding post-2008 self-financing debt).

The Council's approved MRP Policy states that MRP on capital expenditure incurred before 1st April 2008 will be calculated using a regulatory method (known as Option 1) – where MRP is charged in line with previous legislation of a 4% reducing balance basis, with some technical adjustments. This reducing balance method means that historic debt liability would never be fully repaid, and would take around 200 years to reduce to a near-zero level.

Officers have assessed the impact of changing the MRP policy applied to pre-2008 debt liability from a 4% reducing balance to a 2% straight line method. This would involve taking the net pre-2008 liability and fully providing for debt repayment equally over a period of 50 years, broadly equal to the Council's depreciation policy for land and buildings.

Chart 1 below illustrated the change in MRP calculation between the current approach and this proposal.

Chart 1 – MRP calculation

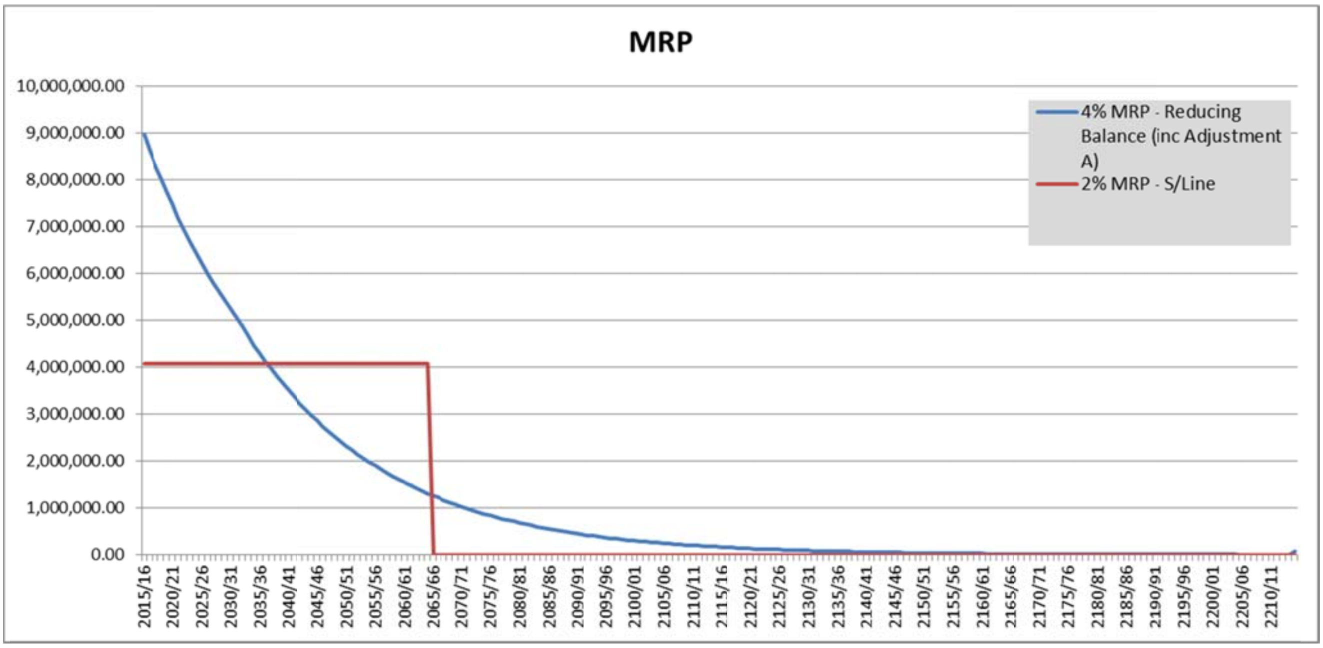
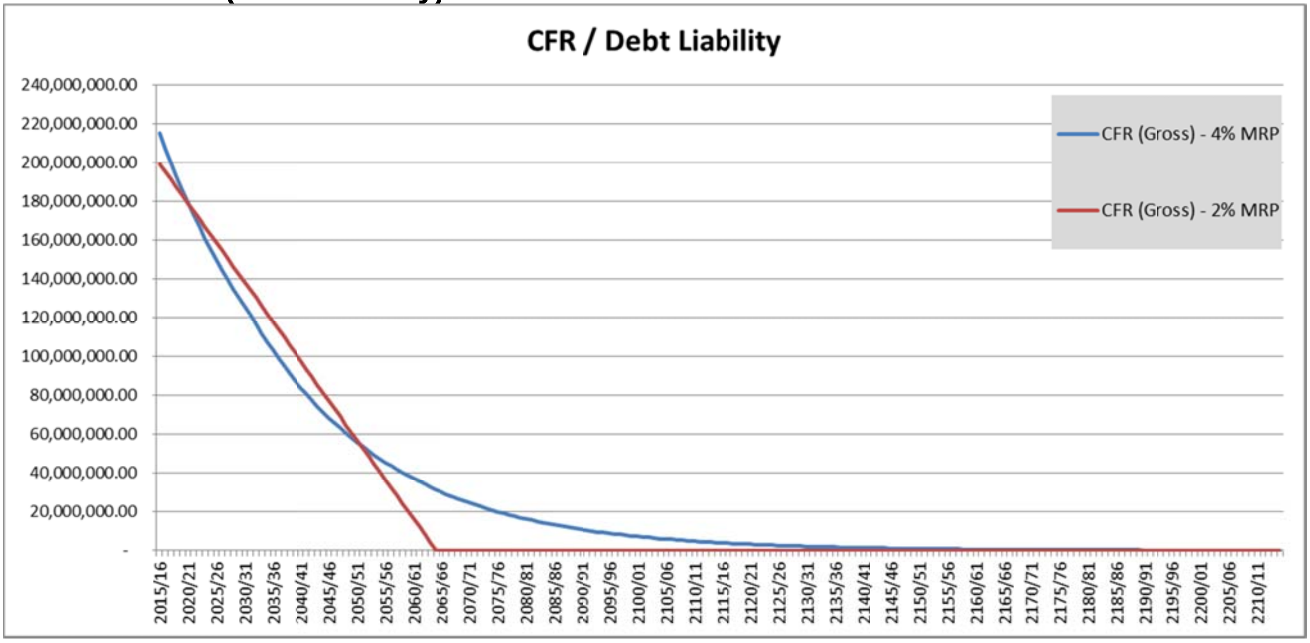


Chart 1 indicates a crossover point between the proposed charge and existing charge in approximately 22 years' time, before the liability is fully extinguished after 50 years and this element of MRP ceases. This re-profiling of MRP provides for a more stable debt financing budget, free from the annual fluctuation caused by a reducing-balance method. Officers have performed a discounted cashflow calculation for each approach and this further supports the case for a change in policy.

The impact upon the Capital Financing Requirement is illustrated in Chart 2 below.

Chart 2 – CFR (Debt Liability)



Re-profiling the MRP charges means that outstanding debt liability will remain higher than under the existing method, with a crossover point after 37 years and the underlying historic debt liability fully repaid after 50 years.

This change in approach to calculating MRP charges has been discussed with external audit, who are supportive of the principles.

Cabinet is asked to approve the revised MRP policy at Annex Ai.