Policy and Scrutiny

Open Report on behalf of Pete Moore, Executive Director Finance and Public Protection

Report to:	**Value for Money Scrutiny Committee**
Date:	**27 September 2016**
Subject:	**Treasury Management Annual Report 2015/16**

Summary:

This report has been prepared in accordance with the reporting recommendations of the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice 2011 and details the results of the Council's treasury management activities for the financial year 2015/16. The report compares this activity to the Treasury Management Strategy for 2015/16, approved by the Executive Councillor for Finance on 23rd March 2015. It will also detail any issues arising in treasury management during this period.

Actions Required:

Members of the Value for Money Scrutiny Committee are invited to consider the report and highlight any comments be passed onto the Executive Councillor with responsibilities for Finance.

1. Background

1. Introduction

Treasury Management relates to the policies, strategies and processes associated with managing the cash and debt of the Council through appropriate borrowing and lending activity. It includes the effective control of the risks associated with the lending and borrowing activity and the pursuit of optimum performance consistent with the risks.

1.1. This Annual Treasury Report will cover the following positions for the year 2015/16:

- An economic overview and interest rate review.
- Investment outturn and comparison with strategy.
- Annual investment strategy/ authorised lending list changes during the year.
- Borrowing outturn and debt rescheduling activity and comparison with strategy.

- Other treasury issues during 2015/16.

2. Economic Overview and Interest Rate Review 2015/16

2.1. At the time of setting the Strategy in February 2015, the markets were forecasting short-term Bank Rate to increase to 0.75% from 0.50% in the last quarter of the financial year for the first time since 2008, in response to the low inflation strong growth environment in the UK.

2.2. Long term rates were forecast to rise over 2015/16 by around 0.50%, but remain extremely volatile and difficult to predict due to upside and downside external market influences.

2.3. The graph below shows the actual movement of both UK long term and short term interest rates over 2015/16.

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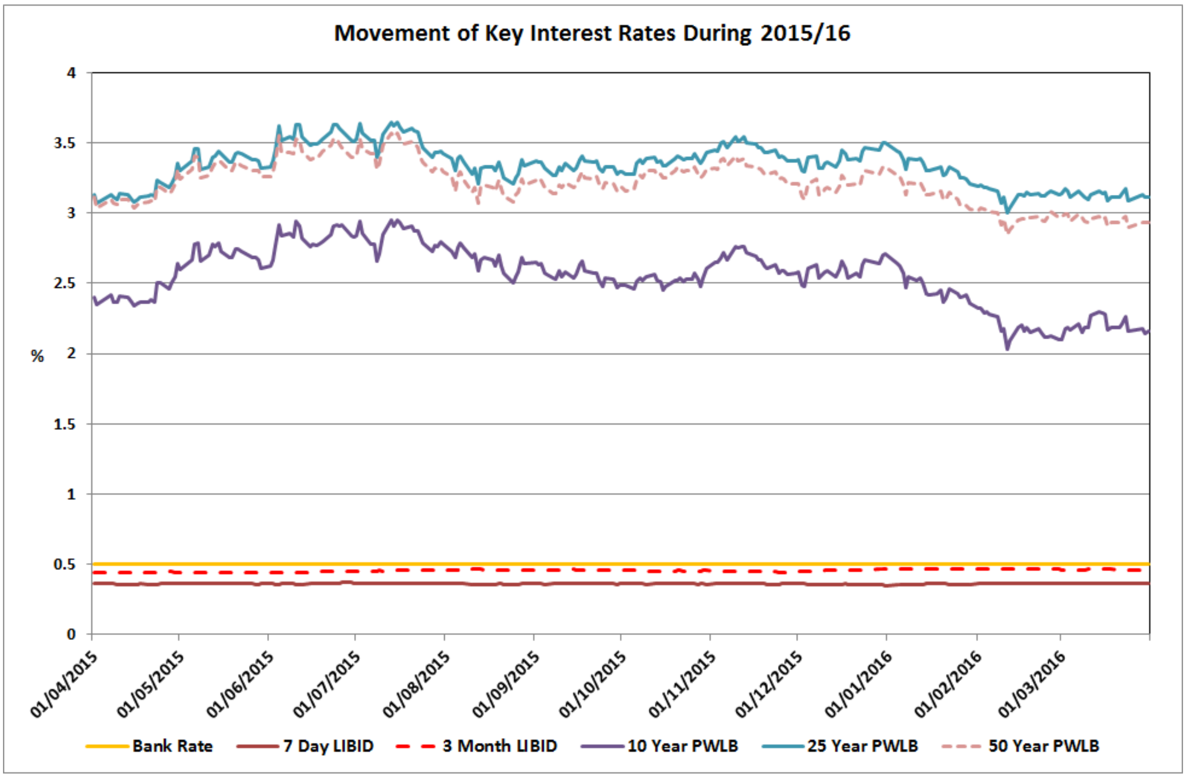

2.4. The graph shows short term rates remained unchanged at 0.50% for the seventh successive year. Market expectations for the first increase in Bank Rate moved radically forward to 2018 amid market fears over economic growth in China, potential destabilisation of some emerging markets, the collapse of oil prices and Eurozone growth uncertainties. These concerns resulted in volatile equity prices and bond yields over the year. Long term rates did however fall to historically low levels by the end of the year as forecasts for inflation were repeatedly revised downwards and expectations of increased central rates pushed back.

2.5. The UK elected a majority Conservative Government in May 2015 removing one potential concern but this introduced another due to the promise of a referendum on the UK remaining part of the EU. These concerns coming to fruition in June 2016 when the UK voted to leave.

2.6. Economic growth in 2015/16 was disappointing compared to previous years falling from 2.9% to 2.1% over the year.

2.7. The ECB commenced their quantitative easing programme in March 2015, purchasing €60bn bonds per month putting downward pressure on Eurozone bond yields. There was a further increase in this programme in Decemeber 2015.

2.8. The US economy continued to grow healthily on the back of resilient consumer demand leading to an increase in the US central rate in December 2015. Concerns around world growth pegged back any further increases to date.

3. Investment Outturn 2015/16 and Comparison with Strategy

3.1. The Council's investment activity, position and return as at 31st March 2016 are detailed in the table below:

Investment Activity 2015/16	**£m**		
Opening Balance at 01.4.2015	158.82		
Investments Made In 2015/16	851.72		
Investments Repaid In 2015/16	785.88		
Closing Balance at 31.3.2016	**224.66**		
Investment Return 2015/16	**Return Annualised**	**Weighted Benchmark Annualised**	**Outperformance**
Year to 31.03.2016	0.73%	0.45%	0.28%

3.2. The investment balance at 31st March 2016 comprised general and earmarked reserves, Pension Fund Cash (£8.6m), income received but not yet used/spent and general movement of working capital. The average value of investments during 2015/16 was £257.7m. The investment balance has risen from the previous year due primarily to both Revenue and Capital underspends in 2015/16.

3.3. In line with the strategy, investments were made in periods of 4 months to 1 year to lock into rates above base rate level, and extensive use of bank call accounts and money market funds were made that offered returns ranging from 0.40% to 0.70%. The weighted average maturity of the investment portfolio lengthened slightly over the year as a result of maintaining the longer dated investments, starting at 117 days and ending at 125 days on 31 March 2016.

3.4. The benchmark target return for investments used is a weighted benchmark that uses both the 7 day LIBID and 3 month LIBID market rates, weighted to better reflect the maturity of the investments made and therefore the risk parameters of the investment portfolio. Being a market rate, this benchmark moves relative to market movement; however market rates have remained flat over the year. The cumulative benchmark rate for 2015/16 was 0.45% compared to 0.41% in 2014/15. The Council outperformed this benchmark by 0.28% in 2015/16 with a return of 0.73%, compared to 0.66% in 2014/15, and produced an investment return of £1.533m, (£1.396m in 2014/15), compared to a forecast of £1.4m. This outperformance was largely achieved due to a number of fixed rate investments in place for most of the year at an average of 1% compared to a lower benchmark rate.

3.5. The investment return was also benchmarked in two other areas for 2015/16 as follows:

- **Capita Benchmarking Analysis**: includes a mixture of 9 authorities in the East Midlands area and 14 English counties.
- **CIPFA Benchmarking Analysis**: includes a mixture of 16 other authorities UK wide.

3.6. The results of this benchmarking for 2015/16 are shown in the table below:

Capita Benchmarking – Position at 31/3/2016			
	LCC	**Benchmark Group(9)**	**English Counties (14)**
March Return %	0.76%	0.69%	0.67%
Risk Banding	0.70% -0.82%	0.62% - 0.74%	0.60% -0.72%
WAM (days)	125	69	62
CIPFA Benchmarking – 2015/16 Position (over year)			
	LCC	**Club (16)**	
Annualised Return %	0.73%	0.80%	
WAM (days)	125	143	

3.7. The benchmarking results show that the Council is above par with the investment returns achieved by its Capita comparators in 2015/16. This is due to a longer Weighted Average Maturity (WAM) position taken by the Council. This is good result given the conservative nature of the Counterparties allowed on the Authorities Lending List (restricted to a Long Term minimum rating of A+) for which these comparators were not restricted to. Capita calculates a risk banding return that should be achievable for the level of risk being taken on investments and the Council is in line with this banding. Compared to the CIPFA comparators, the Council's return and WAM were slightly lower than the benchmarked average. A greater return achieved on longer term investments by the CIPFA group being the reason for this result.

3.8. Temporary borrowing totalling £27m was taken throughout the year to cover a shortfall in liquidity predicted at certain times. The average cost of this temporary borrowing was 0.404%, which was cost neutral as surplus borrowing was invested in money market funds at 0.470%. This was in line with strategy and as an alternative to drawing on higher yielding Notice Accounts when necessary. No temporary borrowing remained outstanding at 31 March 2016.

4. <u>Annual Investment Strategy/Authorised Lending List Changes During 2015/16</u>

4.1. The Council's Annual Investment Strategy for 2015/16 was approved, along with the Treasury Strategy, by the Executive Councillor for Finance on 23rd March 2015 after being scrutinised by this Committee. This outlines the Council's investments priorities as the **security of capital and the liquidity of investments** with the aim to achieve the optimum return on investments commensurate with proper levels of security and liquidity.

4.2. Investments are only placed with highly credit rated financial institutions, using Capita's suggested creditworthiness approach, including Sovereign Credit Ratings and Credit Default Swap overlay information provided by Capita. In addition to Capita's advice, the Council also maintained additional minimum limits of AAA Sovereign, (UK excepted and two out of three agencies), and A+ Long Term Rating (excluding part nationalised banks) for lending to Counterparties. Appendix A shows the Council's Authorised Lending List at 31st March 2016 based on this creditworthiness methodology together with a key explaining the credit rating scores.

4.3. As part of the Annual Strategy for 2015/16, the Council's minimum Long Term Rating requirement was reduced to A+ from AA- to mitigate the expected reduction in credit ratings of institutions by Rating Agencies in 2015 as a result of the banking legislation leading to sovereign support withdrawal.

4.4. The table below shows the additions (mainly from the reduction of the long term limit to A+), removals and limit changes to the Authorised Lending List during 2015/16:

Counterparty	Action	Reason
Additions:		
Westpac Banking Corporation (Australia)	Addition: Limit £20m / 364 Day.	Revised Credit Methodology.
Nordea Bank (Finland)	Addition: Limit £20m / 364 Day.	Revised Credit Methodology.
Nordea Bank (Sweden)	Addition: Limit £20m / 364 Day.	Revised Credit Methodology.
Pohjola Bank (Finland)	Addition: Limit £20m / 364 Day.	Revised Credit Methodology.
DZ Bank (Germany	Addition: Limit £20m / 364 Day.	Revised Credit Methodology.
Bank Nederlande Gemeenten (Netherlands)	Addition: Limit £25m / 24 Months.	Revised Credit Methodology.
Rabobank (Netherlands)	Addition: Limit £20m / 364 Days.	Revised Credit Methodology.
Skandinaviska Enskilda Banken (Sweden)	Addition: Limit £20m / 364 Days.	Revised Credit Methodology.
Swedbank (Sweden)	Addition: Limit £20m / 364 Days.	Revised Credit Methodology.
Bank of New York Mellon (USA)	Addition: Limit £25m / 24 Months.	Revised Credit Methodology.
JP Morgan Chase Bank (USA)	Addition: Limit £20m / 364 Days	Revised Credit Methodology.
Removals:		
LloydsTSB Group (UK)	Removal From List	Loss of Part Nationalised Status

Changes:		
Standard Chartered Bank (UK)	Suspension of Limit	Increase in CDS price.
HSBC Bank plc (UK)	Reduction in Maturity Limit from 364 Day to 6 Months.	Increase in CDS price.
Australia & New Zealand Banking Group (Australia)	Reduction in Maturity Limit from 364 Day to 6 Months.	Increase in CDS price.
Commonwealth Bank of Australia (Australia)	Reduction in Maturity Limit from 364 Day to 6 Months.	Increase in CDS price.
National Australia Bank (Australia)	Reduction in Maturity Limit from 364 Day to 6 Months.	Increase in CDS price.
Westpac Banking Corporation (Australia)	Reduction in Maturity Limit from 364 Day to 6 Months.	Increase in CDS price.

4.5. A full list of the investments held at 31st March 2016, compared to Capita's creditworthiness list and changes to credit rating of counterparties during March 2016 are shown in Appendix B.

4.6. Lloyds Banking Group were removed from the Lending List in May 2015 following its loss of Part-Nationalised status after the Government brought down its holding to less than 20%. Exposure to Lloyds ceased by 31st March 2016.

4.7. At 31st March 2016, the Council had exposure to Standard Chartered Bank (£10m), Commonwealth Bank of Australia (£20m) and National Australia Bank (£5.45m) which all exceeded the Maturity Limits due to CDS price changes. This was not a matter for concern and has since been rectified by repayment or subsequent limit changes.

5. Borrowing Outturn & Debt Rescheduling Activity 2015/16 and Comparison with Strategy

5.1. The Capital Programme expenditure plans were revised during 2015/16 from that agreed by Full Council at its meeting on 20th February 2015 and actual spending was under budget. The result on the corresponding Borrowing Requirement for the year is shown in the table below:

	Original Budget at 1/4/2015 £m	**Final Budget at 31/3/2016 £m**	**Actual at 31/3/2016 £m**	**Underspend £m**
Net Capital Expenditure Programme 2015/16	80.362	94.742	42.697	52.045
Borrowing Requirement 2015/16	73.862	70.761	20.669	50.092

5.2. The Strategy for 2015/16 stated that new borrowing would be undertaken in all periods with the aim of achieving an even spread of maturity profile and keeping an increase in the average cost of the Council's debt to a minimum. Borrowing would be undertaken at a time appropriate to coincide with an identified dip in borrowing rates available.

5.3. The Council's actual borrowing and debt rescheduling position as at 31st March 2016 and activity during 2015/16, is detailed in the table below:

Borrowing Activity 2015/16	**Maturing Debt £m**	**Debt To Fund Capital Expenditure £m**	**Total £m**	**% Cost**
Opening Balance at 1.4.2015	0.0	461.453	461.453	4.147%
New Borrowing in 2015/16	0.0	30.000	30.000	2.910%
Borrowing Matured/Repaid in 2015/16	(11.354)	(0.000)	(11.354)	
Debt Rescheduling:-				
Borrowing Repaid in 2015/16	0.0	0.0	0.0	
Borrowing Replaced in 2015/16	0.0	0.0	0.0	
Closing Balance at 31.3.2016	**(11.354)**	**491.453**	**480.099**	**4.077%**
Authorised Limit For External Debt 2015/16			592.052	

5.4. The table above shows that a total of £30.0m of external borrowing was taken during the year. This borrowing was taken in line with the Strategy whereby £30m was taken from the PWLB in February 2016, when rates dipped to record lows. The borrowing was taken over 44 to 50 years to meet a gap in the maturity profile, at an average rate of 2.91%, hence lowering the existing level of Council debt to 4.07% from 4.14%.

5.5. Total Lenders Option Borrowers Option (LOBO) debt the Council has stands at £30m, well within the limit set in the strategy of 10% of total external debt (equating to £48m). A limit is set on this type of borrowing to limit the amount of variability within the debt portfolio for debt repayment.

5.6. Appendix C shows the maturity profile of the Council's long term debt as at 31st March 2016, including the variability effect of the £30m LOBO debt held. (LOBO debt allows the Lender the opportunity to change the rate on the Loan at specified intervals and the Borrower the option to accept this change or repay the loan.) The graph shows a fairly even maturity profile with no debt maturing in any one year exceeding 9.98% of the total debt portfolio.

5.7. Internal Borrowing is using internal balances to finance capital spend, instead of external borrowing. This strategy reduces interest rate risk (the risk of unexpected adverse changes in interest rate) and credit risk (the risk of default by counterparties to whom investments are held as investment exposure falls) and also provides a net saving in interest costs in the short term. The balance of internal borrowing at 31st March 2016 fell, after taking into account the external borrowing undertaken and the underspend of borrowing requirement in the year, and is broken down as follows:

2011/12	£15.459m
2012/13	£56.486m
2013/14	£26.028m
2014/15	- £13.417m
2015/16	-£18.343m
Total	£66.213m

A further £50.092m of internal borrowing will be carried forward to 2016/17 along with the Capital Programme and Borrowing Requirement underspends, bringing the total internal borrowing to £116.305m. Scope for further internal borrowing after this will be limited as cash balances are run down going forward.

5.8. It is worth pointing out that the internal borrowing balance detailed above can be taken externally at any time if investment interest rate yield curves reverse and move higher than long term borrowing rates in the future.

5.9. The table below shows how the final borrowing requirement for 2015/16 was utilised.

	£m
Final Borrowing Requirement 2015/16	20.669
Made Up Of:	
Voluntary Repayment Debt 2015/16	9.012
Actual Borrowing Undertaken in 2015/16	30.000
Internal Borrowing CF from 2014/15	18.312
Internal Borrowing 2015/16	13.437
Internal Borrowing Underspend CF to 2016/17	-50.092
Total	**20.669**

5.10. No debt rescheduling activity took place during the year due to all existing borrowing loans being in premium position. (Meaning that the coupon rate of existing debt is higher than the current market rate for equivalent outstanding periods and so a premium would be incurred to repay this debt back early).

5.11. Due to the significant underspend of the capital programme borrowing requirement in 2015/16 as detailed in 5.1 above, which has been carried forward to 2016/17, interest paid on long term borrowing was some £1.5m under budget at £19.033m.

5.12. For information purposes the cost of the Council's borrowing was benchmarked by the CIPFA Benchmarking Club (a mix of 16 other authorities UK wide). The average cost of borrowing paid by the members was 4.52% for the year. At 4.07%, the Council's cost of borrowing is below this average.

5.13. Full Council, at its meeting on 20th February 2015, approved the Council's Prudential Indicators for 2015/16, set as a requirement of the Prudential Code to ensure the Council's capital financing, in particular its long term borrowing, is prudent, affordable and sustainable. It can be confirmed that no Prudential Indicator limits were breached during 2015/16. Appendix D compares actual key treasury Prudential Indicators with those estimated for 2015/16.

6. Other Treasury Issues 2015/16

6.1. Shorter term borrowing was maintained throughout 2015/16 to secure the most advantageous position in the event that the Home Office commute to a single lump sum their future liability for grant on loan debt repayments in respect of Magistrates Courts Debt. The balance of this short term debt stood at £73k at 31.3.2016.

2. Conclusion

Short term Interest rates remained flat over the period but long term rates were extremely volatile over the year, ending the year at an all-time low level of below 3%. A slowing economy, weak inflation, falling oil prices and general worldwide concerns affecting markets all played a part in volatile equity and bond prices over the year. The Council's investment return outperformed the market benchmark by 0.28% and the WAM at 31 March 2016 stood at 125 days. This is in line with other benchmark comparators. The cost of the Council's borrowing was 4.07%, which was lower than benchmark comparators. A sum of £30m PWLB borrowing was taken in February 2016 at an average rate of 2.91% in line with the Strategy. This borrowing reduced the Council's internal borrowing to £66.213m at 31st March 2016. A total of £50.092m internal borrowing will be carried forward into 2016/17 along with underspends. Temporary borrowing of £27m was undertaken in 2015/16 to cover predicted liquidity issues. This sum was repaid before 31st March 2016.

3. Consultation

a) Policy Proofing Actions Required

As the contents of this report are factual and the activities being reported on have taken place within existing policies, policy proofing has not been necessary.

4. Appendices

These are listed below and attached at the back of the report	
Appendix A	Authorised Lending List at 31st March 2016 and Credit Rating Key.
Appendix B	Investment Analysis Review at 31st March 2016 - Capita Asset Services Ltd
Appendix C	LCC Long Term Maturity Profile as at 31st March 2016.

Appendix D	Prudential Indicators - Actuals Compared to Estimates 2015/16.

5. Background Papers

The following background papers as defined in the Local Government Act 1972 were relied upon in the writing of this report.

Document title	Where the document can be viewed
Treasury Management Strategy Statement and Annual Investment Strategy 2015/16 23rd March 2016.	Lincolnshire County Council, Finance and Public Protection Directorate.
County Council Report: Council Budget 2015/16 20/2/2015	Lincolnshire County Council, Finance and Public Protection Directorate.

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