AUDIT COMMITTEE

Date of Meeting	Wednesday 13 July 2016
Report Subject	Treasury Management Annual Report 2015/16 Treasury Management Update Q1 2016/17
Cabinet Member	Leader of the Council and Cabinet Member for Finance
Report Author	Corporate Finance Manager
Type of Report	Strategic

EXECUTIVE SUMMARY

The report presents the draft Treasury Management Annual Report 2015/16 for review and seeks the Committee's recommendation for approval to Cabinet.

The report provides an update on matters relating to the Council's Treasury Management Policy, Strategy and Practices 2016/17.

- 1st quarter update 1st April – 30th June 2016, presented for the Committee's information.

RECOMMENDATIONS	
1	Members review the draft Treasury Management Annual Report 2015/16 and identify any matters to be drawn to the attention of Cabinet on 20th September 2016.
2	Members note the Treasury Management 2016/17 Q1 quarterly update.

REPORT DETAILS

1.00	EXPLAINING THE ANNUAL REPORT
1.01	The Council has nominated Audit Committee to be responsible for ensuring effective scrutiny of Treasury Management Strategy and Policies. The Audit Committee has previously agreed to include Treasury Management as a standing item on each quarterly agenda to receive an update.
1.02	On 17th February 2015, the Council approved the Treasury Management Investment Strategy 2015/16, following the recommendation of the Cabinet and consideration by the Audit Committee.
1.03	On 16th February 2016, the Council approved the Treasury Management Strategy 2016/17, following the recommendation of the Cabinet and consideration by the Audit Committee.
	CONSIDERATIONS
1.04	Governance A schedule for the reporting cycle for Treasury Management reports 2016/17 is attached as Appendix 1 for information. Where Members have any specific items of interest, concern or questions on the Council's Treasury Policy or Investment Strategy these can be addressed within these reports upon request.
	Treasury Management Annual Report 2015/16
1.05	The draft Treasury Management Annual Report for 2015/16 is attached as Appendix 2 for review. As required by the Council's Financial Procedure Rules, this Annual Report will be reported to the Cabinet and Council.
1.06	Summary of Key Points The UK bank base interest rate remained at its historic low of 0.5% throughout the year. This was reflected in the low level of interest that the Council was able to generate on its investments; the average interest rate for investments during the year was 0.51%. Section 2 of the annual report provides a review of the economy and interest rates, and Section 4 provides further details of the Council's investment activity during the year.
1.07	£79.2m of new borrowing was taken out in respect of the HRA Subsidy Reform. This is detailed in paragraph 3.04.
1.08	Debt rescheduling opportunities were considered by officers and the Council's Treasury Management advisors. However, the premium charged for repaying high interest rate debt or replacing it with debt at a lower interest rate was deemed too expensive and therefore made any debt rescheduling

	unattractive. Section 3 of the annual report provides more information on borrowing and debt management during the year.
1.09	The treasury function operated within the limits detailed in the Treasury Management Strategy 2015/16.
	Treasury Management 2016/17 – Quarter 1 update
1.10	<u>Investments Update</u> A statement setting out the Council's investments as at 30th June 2016 is attached at Appendix 3. The investment balance at this time was £22.9m, spread across 10 counterparties and the average investment rate was 0.56% for the quarter.
1.11	In the days leading up to the EU referendum on 23rd June 2016 consideration was given to the impact that either decision would have on the UK's general banking systems. There were some concerns that a 'leave' vote would lead to an increase in the volume of transactions being processed leading to short term liquidity issues in the days following the result. Officers discussed the situation with the Council's advisors and a purely precautionary measure to invest enough cash to cover payments due to be made the following week with the government's Debt Management Office rather than any other financial institution was taken.
1.12	There was some immediate but minor disruption to institutional transactions early on Friday 24th June 2016 with Clearing banks introducing some changes to the way they operate which is likely to continue. Otherwise, for transactions it's business as usual.
1.13	Officers have been in regular contact with, and have been receiving updates from, Arlingclose Ltd, the Council's treasury management advisors regards the creditworthiness of financial institutions following the 'leave' vote. No changes have been made to the counterparty list and the situation will continue to be closely monitored.
1.14	<u>Borrowing Update</u> Appendix 4 shows the Council's borrowing as at 30th June 2016. The total amount of loans outstanding was £251.3m and the average interest rate payable was 5.02%.
1.15	The 2016/17 Treasury Management Strategy forecast that the Council would need to borrow during the year to fund its enhanced capital programme. The market uncertainty caused by the EU referendum has resulted in borrowing rates being lower than projected. Consideration has therefore been given to the Council's borrowing requirement during June and the borrowing forecast was updated.
1.16	Whilst capital requirements remained roughly the same, the level of reserves that the Council held on 31st March 2016 was significantly higher than forecast, indicating that the point at which the Council needs to borrow

	will be later than planned in the Strategy. Experience signals that forecasts for capital expenditure and planned use of reserves are usually over estimated.
1.17	The 'leave' result indicates that interest rates will remain lower for longer and short term rates in particular are very likely to remain low for many years to come.
1.18	Various options have been modelled with the most cost effective and low risk option being to make use of short term and variable rate borrowing when the need arises. This will protect the Council from; • the risk of committing to medium to longer term borrowing that was not needed, and • additional credit and counterparty risk from borrowing before need and any associated costs as borrowing rates are higher than returns on investments.
1.19	<u>Lending to NEW Homes to fund affordable homes in Flint</u> Members will be aware that the Cabinet in May 2016 approved a loan to the Council's wholly owned company, NEW Homes Ltd, to build 62 homes on the site of The Walks in Flint for rent at affordable levels.
1.20	The Council will fund the loan to NEW Homes by borrowing itself and therefore a report to increase the Council's borrowing limit was approved by Council in June 2016 (Authorised Limit for External Debt). The borrowing and the lending will be independent transactions and will therefore have the impact of increasing the Council's borrowing position. For simplicity and transparency the additional Council loans for NEW Homes purposes will be separately identified within the Council's loan portfolio.
1.21	As the loan to NEW Homes is being made to achieve the Council's strategic objectives within the Improvement Plan, it does not meet the definition of an investment within the Treasury Management Strategy. Investments are the use of surplus cash as a result of timing differences between receiving and spending cash to generate a return, with the focus on security, liquidity and finally yield. This has been confirmed by the Council's treasury management advisors.
1.22	Further information is included in 17th May Cabinet report and the 14th June Cabinet report.

2.00	**RESOURCE IMPLICATIONS**
2.01	Financial implications are addressed in the report; no other resource implications directly as a result of this report.

3.00	CONSULTATIONS REQUIRED / CARRIED OUT
3.01	Arlingclose Ltd, being the Council's treasury management advisors.

4.00	RISK MANAGEMENT
4.01	Risk Management directly addressed within the report and appendices including identification of risks and measures to mitigate likelihood and impact of risks identified.

5.00	APPENDICES
5.01	1. Treasury Management Reporting Cycle 2016/17 2. Draft Treasury Management Annual Report 2015/16 3. Investment Portfolio as at 30 June 2016 4. Borrowing Portfolio as at 30 June 2016

6.00	LIST OF ACCESSIBLE BACKGROUND DOCUMENTS
6.01	**Contact Officer:** Liz Thomas – Technical Finance Manager **Telephone:**01352 702289 **E-mail:**liz.thomas@flintshire.gov.uk

7.00	GLOSSARY OF TERMS
7.01	**Authorised Limit:** A statutory limit that sets the maximum level of external debt for the Council. **Balances and Reserves**: Accumulated sums that are held, either for specific future costs or commitments (known as earmarked) or generally held to meet unforeseen or emergency expenditure. **Bank Rate:** The official interest rate set by the Bank of England's Monetary Policy Committee and what is generally termed at the "base rate". **Basis Point:** A unit of measure used in finance to describe the percentage change in the value or rate of a financial instrument. One basis point is equivalent to 0.01% (1/100th of a percent). In most cases, it refers to changes in interest rates and bond yields. For example, if interest rates rise by 25 basis points, it means that rates have risen by 0.25% percentage points. **Bond:** A certificate of debt issued by a company, government, or other institution. The bond holder receives interest at a rate stated at the time of issue of the bond. The price of a bond may vary during its life.

Capital Expenditure: Expenditure on the acquisition, creation or enhancement of capital assets.

Capital Financing Requirement (CFR): The Council's underlying need to borrow for capital purposes representing the cumulative capital expenditure of the local authority that has not been financed.

Certificates of Deposits (CD's): A savings certificate entitling the bearer to receive interest. A CD bears a maturity date, a specified fixed interest rate and can be issued in any denomination. CDs are generally issued by commercial banks. The term of a CD generally ranges from one month to five years.

Cost of Carry: The "cost of carry" is the difference between what is paid to borrow compared to the interest which could be earned. For example, if one takes out borrowing at 5% and invests the money at 1.5%, there is a cost of carry of 3.5%.

Consumer Price Index (CPI): The UK's main measure of inflation (along with Retail Price Index or 'RPI') The Monetary Policy Committee of the Bank of England set the Bank Rate in order to try and keep CPI at or close to the target set by the Government. The calculation of CPI includes many items of normal household expenditure but excludes some items such as mortgage interest payments and Council Tax.

Credit Rating: Formal opinion by a registered rating agency of a counterparty's future ability to meet its financial liabilities; these are opinions only and not guarantees.

Corporate Bonds: Corporate bonds are bonds issued by companies. The term is often used to cover all bonds other than those issued by governments in their own currencies and includes issues by companies, supranational organisations and government agencies.

Counterparty List: List of approved financial institutions with which the Council can place investments.

Debt Management Office (DMO): The DMO is an Executive Agency of Her Majesty's Treasury and provides direct access for local authorities into a government deposit facility known as the Debt Management Account Deposit Facility (DMADF). All deposits are guaranteed by HM Government and therefore have the equivalent of a sovereign credit rating.

Federal Reserve: The US central bank, the equivalent of the Bank of England. (Often referred to as "the Fed").

Financial Instruments: Financial instruments are tradable assets of any kind. They can be cash, evidence of an ownership interest in an entity, or a contractual right to receive or deliver cash or another financial instrument.

Gilts: Gilts are bonds issued by the UK Government. They take their name from 'gilt-edged'. They are deemed to be very secure as the investor expects to receive the full face value of the bond to be repaid on maturity.
LIBID: The London Interbank Bid Rate (LIBID) is the rate bid by banks on

Eurocurrency deposits (i.e. the rate at which a bank is willing to borrow from other banks).

LIBOR: The London Interbank Offered Rate (LIBOR) is the rate of interest that banks charge to lend money to each other. The British Bankers' Association (BBA) work with a small group of large banks to set the LIBOR rate each day. The wholesale markets allow banks who need money to borrow from those with surplus amounts. The banks with surplus amounts of money are keen to lend so that they can generate interest which it would not otherwise receive.

LOBO: Stands for Lender Option Borrower Option. The underlying loan facility is typically very long-term - for example 40 to 60 years - and the interest rate is fixed. However, in the LOBO facility the lender has the option to call on the facilities at pre-determined future dates. On these call dates, the lender can propose or impose a new fixed rate for the remaining term of the facility and the borrower has the ‘option’ to either accept the new imposed fixed rate or repay the loan facility.

IFRS: International Financial Reporting Standards.

Maturity: The date when an investment or borrowing is repaid.

Maturity Structure / Profile: A table or graph showing the amount (or percentage) of debt or investments maturing over a time period.

Monetary Policy Committee (MPC): Government Body that sets the Bank Rate. Its primary target is to keep inflation within 1% of a central target of 2%. Its secondary target is to support the Government in maintaining high and stable levels of growth and employment.

Money Market Funds (MMF): Pooled funds which invest in a range of short term assets providing high credit quality and high liquidity.

Minimum Revenue Provision (MRP): An annual provision that the Council is statutorily required to set aside and charge to the Revenue Account for the repayment of debt associated with expenditure incurred on capital assets.

Non Specified Investment: Investments which fall outside the WG Guidance for Specified investments (below).

Operational Boundary: This linked directly to the Council’s estimates of the CFR and estimates of other day to day cash flow requirements. This indicator is based on the same estimates as the Authorised Limit reflecting the most likely prudent but not worst case scenario but without the additional headroom included within the Authorised Limit.

Premiums and Discounts: In the context of local authority borrowing,
(a) the premium is the penalty arising when a loan is redeemed prior to its maturity date and
(b) the discount is the gain arising when a loan is redeemed prior to its maturity date.
Prudential Code: Developed by CIPFA and introduced in April 2004 as a

professional code of practice to support local authority capital investment planning within a clear, affordable, prudent and sustainable framework and in accordance with good professional practice.

Prudential Indicators: Indicators determined by the local authority to define its capital expenditure and asset management framework. They are designed to support and record local decision making in a manner that is publicly accountable; they are not intended to be comparative performance indicators.

Public Works Loans Board (PWLB): The PWLB is a statutory body operating within the United Kingdom Debt Management Office, an Executive Agency of HM Treasury. The PWLB's function is to lend money from the National Loans Fund to local authorities and other prescribed bodies, and to collect the repayments.

Quantitative Easing (QE): In relation to the UK, it is the process used by the Bank of England to directly increase the quantity of money in the economy. It does not involve printing more banknotes. Instead, the Bank buys assets from private sector institutions – that could be insurance companies, pension funds, banks or non-financial firms – and credits the seller's bank account. So the seller has more money in their bank account, while their bank holds a corresponding claim against the Bank of England (known as reserves). The end result is more money out in the wider economy.

Revenue Expenditure: Expenditure to meet the continuing cost of delivery of services including salaries and wages, the purchase of materials and capital financing charges.

Retail Price Index (RPI): A monthly index demonstrating the movement in the cost of living as it tracks the prices of goods and services including mortgage interest and rent.

Term Deposits: Deposits of cash with terms attached relating to maturity and rate of return (Interest).

Specified Investments: Term used in the Welsh Assembly Guidance for Local Authority Investments. Investments that offer high security and high liquidity, in sterling and for no more than one year. UK government, local authorities and bodies that have a high credit rating.

Supported Borrowing: Borrowing for which the costs are supported by the government or third party.

Supranational Bonds: Instruments issued by supranational organisations created by governments through international treaties (often called multilateral development banks). The bonds carry an AAA rating in their own right. Examples of supranational organisations are the European Investment Bank, the International Bank for Reconstruction and Development.

Treasury Bills (T-Bills): Treasury Bills are short term Government debt instruments and, just like temporary loans used by local authorities, are a means to manage cash flow. They are issued by the Debt Management

	Office and are an eligible sovereign instrument, meaning that they have an AAA-rating. **Treasury Management Code**: CIPFA's Code of Practice for Treasury Management in the Public Services, initially brought in 2003, subsequently updated in 2009 and 2011. **Treasury Management Practices (TMP):** Treasury Management Practices set out the manner in which the Council will seek to achieve its policies and objectives and prescribe how it will manage and control these activities. **Temporary Borrowing:** Borrowing to cover peaks and troughs of cash flow, not to fund capital spending. **Unsupported Borrowing**: Borrowing which is self-financed by the local authority. This is also sometimes referred to as Prudential Borrowing. **Yield:** The measure of the return on an investment instrument.