DECISION ITEM

REPORT OF	MEETING	DATE	ITEM NO
FINANCE	COUNCIL	14 DECEMBER 2015	11

MID YEAR PRUDENTIAL INDICATORS AND TREASURY MANAGEMENT MONITORING REPORT 2015/16

PUBLIC ITEM

This item is for consideration in the public part of the meeting.

SUMMARY

This report is a mid-year Prudential Indicators and Treasury Management monitoring report which has been prepared in line with the recommendations of CIPFA's (Chartered Institute of Public Finance Accountants) Code of Practice on Treasury Management 2011, and has been scrutinised by the Audit and Standards Committee.

RECOMMENDATIONS

The Audit and Standards Committee has considered the Mid-Year Prudential Indicators and Treasury Management monitoring report at its meeting of 26th November 2015 and recommends to Council:

1. That the revised Investment Strategy be approved; and
2. That the Prudential Indicators and the Limits in Appendix B of this report be approved.

CORPORATE PRIORITIES			
To Promote the Enhancement of The Natural & Built Environment (**Place**)		To Encourage Cohesive Communities (**People**)	
To Promote a Thriving Economy (**Prosperity**)	√	To Meet Expectations of our Customers (**Performance**)	√

SUMMARY OF PREVIOUS DECISIONS

1. Council approved the 2015/16 to 2017/18 Treasury Management Strategy & Prudential Indicators at its meeting on 3rd March 2015.

MID YEAR PRUDENTIAL INDICATORS AND TREASURY MANAGEMENT MONITORING REPORT 2015/16 – POSITION AS AT 30th SEPTEMBER 2015

Report

The Code of Practice on Treasury Management requires the Council to receive a Mid-Year Treasury Review report in addition to the forward-looking Annual Treasury Strategy and the backward-looking Annual Treasury Report. The Code of Practice also requires Members to scrutinise the Treasury Management function.

Background

The Mid-Year Treasury Review report has been prepared in compliance with the Code of Practice. In order to assist with the terminology and explanations that are included within this report Appendix A sets out a Glossary of Treasury Terms and a number of Treasury Management and Prudential Indicators Frequently Asked Questions. Appendix B sets out the latest Treasury Management position compared to the forecast Prudential Indicators.

1. Economic Update

1.1 Economic Background

As the year began, the economic outlook was largely overshadowed by events in Greece with the country at serious risk of an exit from the Euro. In July it was announced that the terms for a third bailout of Greece had been reached.

The summer saw attention shift towards China when its main stock market dropped in value by 43% in less than three months with a reported $3.2 trillion loss to investors. The Chinese authorities intervened by halting trading in many stocks and changing the way the yuan (Chinese currency) is valued. This sent jitters through Asian, European and US markets impacting currencies, equities, commodities, oil and metals. Chinese stocks have recovered marginally and concern remains about slowing growth and deflationary effects.

These international concerns have dominated the economic sentiment during the first half of 2015/16.

The UK economy has remained resilient over the last six months. Economic growth (GDP) for the year to June 2015 was 2.6%.

The annual rate for consumer price inflation (CPI) turned negative to -0.1% for the year to September 2015. The main factors contributing to the decrease in CPI are falling prices in clothing and footwear, fuel and gas. Inflation is expected to gradually increase to around 2% over the next 18 months.

1.2 Economic Outlook for 2015/16

The expectation for the first rise in the Bank Rate remains the second half of 2016. The pace of interest rate rises will be gradual and the extent of rises limited. The weak global environment and low inflation expectations are likely to dampen long term interest rates.

1.3 Interest Rate Forecast

The latest forecast for interest rates from the Council's Treasury Advisors, Arlingclose, is shown in table 1 below.

Table 1: Interest Rate Forecast from Arlingclose

Quarter Ending	Bank Rate %	Investment Rates		Borrowing Rates		
		3 month %	1 year	5 year	20 year	50 year
Dec 2015	0.50	0.55	1.10	2.30	3.25	3.25
Mar 2016	0.50	0.60	1.20	2.35	3.30	3.30
Jun 2016	0.50	0.70	1.35	2.40	3.35	3.35
Sep 2016	0.75	0.80	1.45	2.50	3.40	3.40
Dec 2016	0.75	0.95	1.55	2.60	3.45	3.45
Mar 2017	1.00	1.05	1.70	2.70	3.50	3.50
Jun 2017	1.00	1.15	1.80	2.80	3.55	3.55
Sep 2017	1.25	1.30	1.95	2.90	3.60	3.60
Dec 2017	1.25	1.40	2.00	3.00	3.65	3.65
Mar 2018	1.50	1.55	2.10	3.05	3.70	3.70
Jun 2018	1.50	1.65	2.15	3.10	3.75	3.75
Sep 2018	1.75	1.80	2.15	3.15	3.80	3.80
Dec 2018	1.75	1.85	2.15	3.15	3.80	3.80

2. Debt Management

The Council currently has long-term debt of £2.3M at an average rate of 2.93%. No additional external borrowing has taken place during the current financial year.

The Council has a requirement to fund a further £4.0M in 2015/16 (the £6.3M Capital Financing Requirement, or CFR, less £2.3M already borrowed) based on Prudential Borrowing that has been approved as part of the Capital Programme. The CFR of £6.3M (See Appendix B Table 2) includes this Prudential Borrowing. Currently this is being funded by the Council's cash flow, i.e. internal borrowing, and it is expected that internal borrowing will continue to be used for the rest of the financial year in line with advice from the Council's Treasury Advisors.

The use of internal resources in lieu of borrowing, i.e. internal borrowing, has continued to be the most cost effective means of funding capital expenditure. Internal borrowing of £4.0M is being used to fund the Capital Programme in 2015/16. The budget forecast for interest payable is £220K and was based on the assumption that the Council would borrow externally. As internal borrowing is being used instead this will generate a saving and the interest payable budget will be revised down from £220K to £70K. Using internal borrowing lowers the overall treasury risk by reducing both external debt and temporary investments. However, this position will not be sustainable over the medium term. Consequently, external borrowing options and the timing of such borrowing will continue to be assessed in conjunction with the Council's Treasury Advisors.

The Council has recently been advised that it has qualified for borrowing at the 'Certainty Rate' (0.20% below the PWLB standard rate) for a further 12 month period (from 1st November 2015) having earlier qualified for the period from November 2014 to October 2015.

3. Investments

3.1 Investment Activity

The guidance on Local Government Investments in England gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles.

The security of capital has remained the Council's main investment objective. This has been maintained by following the Council's counterparty policy as set out in the Investment Strategy for 2015/16 approved by Council on 3rd March 2015.

The Council defines "high credit quality" organisations as:

- those having a credit rating of A- or higher and that are domiciled in the UK for deposits of up to one year,
- those domiciled in a foreign country those with a sovereign rating of AA+ or higher for deposits of up to one year,
- Those having a credit rating of BBB+ or higher for periods of up to one month.

These criteria are specified within table 3 (Approved Investment Counterparties) of the Treasury Management Strategy as approved by the Council on 3rd March 2015.

The Council held £18.2M of investments as at 30th September 2015. These investments represent the Council's reserves and balances plus surplus cash flow at the mid-year point. The balance of cash is likely to reduce during the remainder of the financial year.

The UK Bank Rate has been maintained at 0.5% since March 2009 and it is not expected to rise until September 2016. Short-term money market rates have remained at very low levels. Deposits have been made at an average rate of 0.36% in line with the benchmark return of 0.36%. The Council's original estimate for investment income for 2015/16 was £30K. Income from investments has been higher than the forecast amount due to higher than anticipated cash balances and consequently this income budget has been reviewed and will be increased to £50K to reflect the current level of income.

3.2 Bail-in Risk

In the past governments had only two options to resolve failing banks: insolvency; or a taxpayer funded bail-out. Recent banking reform legislation has introduced a third option which allows customers to retain access to their bank accounts, but passes the banks losses onto its investors instead of taxpayers. This is known as a "bail-in".

Local Authorities are not protected from bail in as it is expected that Public Authorities have better access to credit than citizens. Many depositors (such as corporate and retail customers) will rank above the Council in the event of a bail-in.

To respond to this risk the Council will continue to diversify the investment portfolio into more secure asset classes including Treasury Bills that are issued by the UK Central Government.

3.3 Treasury Bills

The Council may invest in Treasury Bills which are a marketable security issued by the UK Government and as such counterparty and liquidity risk is very low, although there is potential risk to value arising from an adverse movement in interest rates unless they are held to maturity. It is anticipated that the Council would normally hold to maturity to avoid any capital loss of selling early.

There are weekly tenders held for treasury bills so the Council can invest funds on a regular basis, based on projected cash flow information. There is a secondary market for treasury bills so it is possible to trade them in earlier than the maturity date if required.

The current approved Investment Strategy permits investments to the UK Government for an unlimited amount and for up to one year in duration.

4. Compliance with Prudential Indicators

The Council has complied with its Prudential Indicators for 2015/16, which were approved on 3rd March 2015 as part of the Council's Medium Term Financial Strategy Update, Including General Fund, Capital Programme and Treasury Management for 2014/15 to 2018/19.

Details of the Prudential Indicators can be found in Appendix B. As changes arise during the year some of the Prudential Indicators and Limits need to be revised.

5. Risk Assessment

Scrutiny of the revised Prudential Indicators and Limits and the subsequent recommendation of approval to the revisions by Audit and Standards Committee to Council helps to protect the Council from the risk of not having adequate liquidity or funding for the Council's capital plans.

Additionally, if this scrutiny process were absent the Council would not be compliant with the Council's approved Treasury Management Practices (as detailed in the Council Constitution) or CIPFA's Code of Practice on Treasury Management.

6. Conclusion

In compliance with the requirements of the CIPFA Code of Practice this report provides members with a summary report of the treasury management activity during the first half of 2015/16. As indicated in this report, none of the Prudential Indicators have been breached and a prudent approach has been taking in relation to investment activity with priority being given to security and liquidity over yield.

IMPLICATIONS	
Finance	Financial implications are contained within the body of the report.
Legal	This report secures the continued compliance with the Council's approved Treasury Management Practices (as detailed in the Council Constitution) and CIPFA's Code of Practice on Treasury Management.
Community Safety	None
Human Rights and Equalities	None
Sustainability and Environmental Impact	None
Health & Safety and Risk Management	None

LEAD AUTHOR	TEL	DATE	DOC ID
Paul O'Donoghue Chief Financial Officer	01253 658586	December 2015	

LIST OF BACKGROUND PAPERS		
Name of document	Date	Where available for inspection
Medium Term Financial Strategy Update Including General Fund, Capital Programme & Treasury 2015/16 – 2019/20	Council meeting 3rd March 2015	www.fylde.gov.uk

Attached documents

1. Appendix A – Glossary of Treasury Terms and Treasury Management and Prudential Indicators Frequently Asked Questions
2. Appendix B – Prudential Indicators

Appendix A

Glossary of Treasury Terms

Term	Description
Counterparty	Another party to an agreement.
Credit rating	A measure of the credit worthiness of an institution, corporation, or a country. Credit ratings are calculated from financial history and current assets and liabilities. Typically, a credit rating tells a lender or investor the probability of the counterparty being able to pay back a loan.
Liquidity	As assessment of how readily available an investment is. It is safer to invest in liquid assets because it is easier for an investor to get their money out of the investment.
Minimum Revenue Provision (MRP)	The minimum amount that the Council must charge to the accounts each year in order to meet the costs of repaying amounts borrowed.
Public Works Loan Board (PWLB)	PWLB is part of HM Treasury and lends money to local authorities.
Security	As assessment of the creditworthiness of a counterparty.
Treasury adviser	External consultancy firms that provide information to local authorities, including information regarding counterparty creditworthiness.
Bail-in	A bail-in takes place before bankruptcy and under current proposals, certain types of depositors would suffer a reduction in the amount of their deposit that would be returned to them whilst other classes of investor would not.

Treasury Management and Prudential Indicators Frequently Asked Questions

1. What is the difference between capital expenditure and capital financing requirement?

Capital Expenditure is defined as expenditure on the acquisition, creation or enhancement of tangible fixed assets, subject to a de minimis level of £10,000. It includes expenditure on land, buildings and vehicles.

The Capital Financing Requirement (CFR) is the level of total funding that is required to fund the capital programme. The actual level of external borrowing may be lower than the CFR as a consequence of the use of internal borrowing. Internal Borrowing occurs when the Council temporarily uses its own cash resources to finance capital expenditure rather than arranging new external borrowing. This is a prudent approach when investment returns are low and counterparty risk is high.

2. What does the term 'financing' mean?

The term 'financing' does not refer to the payment of cash but the resources that will be applied to ensure that the capital payment amount is dealt with over the longer term. A number of financing options are available to Councils:-

- capital receipts (e.g. sale of land or buildings)
- contribution from revenue expenditure
- capital grant
- contribution from a third party
- borrowing
- contribution from earmarked reserves

3. Does the Council link long term loans to particular capital assets/projects?

The Council does not directly associate loans with particular capital assets/projects, as it is not best practice. The Council will, at any point in time, have a number of cash flows both positive and negative and will be managing its position in terms of its borrowings and investments in accordance with its treasury management strategy and practices. This is best practice in line with the CIPFA Prudential Code.

4. What does the term 'net borrowing should not exceed the total of the CFR' mean?

Net borrowing will remain below the CFR to ensure that the Council is only borrowing for a capital purpose. The Council is permitted to borrow in advance for a capital purpose over the medium term. The term 'total of the CFR' is the CFR of the current year plus increases in the CFR of the previous financial year and next two financial years. In other words, the total of the Council's existing assets, plus additions to assets resulting from forecast Capital Programme expenditure, e.g. vehicles. This gives the Council some headroom to borrow early for a capital purpose in order to secure low interest rates.

5. Is the cash that is being managed in-house revenue or capital?

The short term surplus cash that is managed during the year in house may be revenue or capital, e.g. the Council may receive a capital receipt in April but capital expenditure is incurred throughout the year which gives rise to increased cash balances in the early part of the financial year which is invested short term by the in house treasury team. The Council receives Council Tax which is classed as revenue income. Council Tax income is typically received in the months of April to January as Council Tax payers make 10 instalments. Therefore, the Council has less cash in the months of February and March and may need to borrow cash short-term in line with the cash flow forecast.

6. What does the Council invest in?

The Council is restricted in where it can invest its surplus funds. The restrictions are prescribed by statute (Local Government Act 2003 section 15(1) (a)). Councils are also required to have regard to supplementary investment guidance provided by the Communities and Local Government.

The Council's investments are typically short term, i.e. less than a year, and are made in sterling with institutions with high credit ratings. Which is in accordance with the Treasury Management Strategy approved on the 3rd March 2014.

7. What is the role of internal and external auditors in respect of treasury management?

The focus of external auditors work is a Council's annual accounts and the financial management systems and processes that underpin them. The external audit will enquire as to whether the Treasury Management Code has been adopted and whether its principles and recommendations have been implemented and adhered to. External auditors cannot comment or advise on Council's treasury management strategy or policies

Through a process of review, the role of Internal Audit is to provide an opinion of the adequacy, application and reliability of the key internal controls put in place by management to ensure that the identified risks are sufficiently mitigated. This will assist Treasury Management in meeting its desired objectives and help to ensure that the risk of fraud and/or error is minimised. Internal Audit will also look to identify other areas of potential risk which could usefully be included as well as any inefficiencies in existing processes and procedures where improvements can be made. Treasury Management is one of the core financial systems and as such is audited on a cyclical basis.

8. What are the qualifications of Council staff involved in treasury management practices?

Staff are either working towards or have achieved professional accountancy qualifications from CIPFA (Charted Institute of Public Finance Accountants), ACCA (Association of Chartered Certified Accountants) or CIMA (Chartered Institute of Management Accountants). Staff work closely with Treasury Management Advisors and attend treasury training and updates provided by the Treasury Management Advisor

Appendix B

Prudential Indicators

1.1 Capital Expenditure

Table 1 shows the revised forecast capital expenditure as reported in the latest Capital Programme Monitoring Report 2015/16 as compared to the capital expenditure originally approved by Council.

Table 1 Forecast Capital Expenditure

Forecast Capital Expenditure	2015/16 Original Indicator £M	2015/16 Latest Estimate £M
Total	3.9	4.2

The above table shows the forecast capital expenditure on new projects. The increase in the latest estimate is mainly a consequence of slippage from 2014/15 into 2015/16, re-phasing of the accommodation project and St.Annes regeneration scheme plus increased DFG grant allocation.

1.2 Capital Financing Requirement (CFR)

Table 2 shows the CFR which is the total of all of the Council's capital assets (existing and planned) less all of the Council's capital reserves. This is the amount of capital expenditure that the Council has still to finance. The CFR is normally funded by external borrowing. The Council has borrowed £2.3M and there is a requirement to finance £4.0M from internal cash resources.

Table 2 Capital Financing Requirement (CFR)

	2015/16 Original Indicator £M	2015/16 Latest Estimate £M
Total CFR	6.3	6.3

The latest estimate of the CFR is in line with the original approved indicator.

1.3 Gross Borrowing

The Council needs to ensure that its total capital borrowing does not, except in the short term, exceed the total of the CFR. Table 3 below shows that the Council will be able to comply with this requirement.

There are no difficulties anticipated in keeping the long term capital borrowing below the CFR. Revenue borrowing may be incurred for short periods in line with cash flow requirements.

Table 3 Gross Borrowing

	2015/16 Original Indicator £M	2015/16 Revised Indicator £M
Gross Borrowing Indicator	6.3	2.3
Short Term Borrowing (Revenue)	0	0
Gross Borrowing (Capital)	**6.3**	**2.3**
CFR	**6.3**	**6.3**
Under Borrowing (Capital)	**0**	**4.0**

The Gross Borrowing Indicator has decreased as the Council is forecast to be able to fund the capital borrowing requirement with internal borrowing and does not expect to require new external borrowing during 2015/16, in line with advice from Treasury Advisors.

1.4 Operational Boundary and Authorised Limit for External Debt

The Operational Boundary is based on the maximum external debt during the course of the year. It is not a limit and therefore may be exceeded on occasion.

The Authorised Limit for external debt represents the limit beyond which borrowing is prohibited, and is set and revised by Council. It reflects the level of borrowing which, in extreme circumstances, could be afforded in the short term. This is a statutory limit which should not be breached.

There were no breaches to the Authorised Limit and the Operational Boundary to 30th September 2015.

Table 4 Operational Boundary and Authorised Limit for External Debt

	2015/16 Original Indicator £M	2015/16 Revised Indicator £M	Note
Existing Capital Borrowing	6.3	2.3	1
Gross Borrowing Indicator	**6.3**	**2.3**	
Operational Boundary	**6.3**	**2.3**	1
Contingency	6.0	6.0	2
Authorised Limit	**12.3**	**8.3**	

Note

1. The Gross Borrowing Indicator and Operational Boundary have decreased as the Council is able to fund the capital borrowing requirement with internal borrowing and does not expect to require new external borrowing during 2015/16.

2. The Authorised Limit includes £6.0M for 'contingency' which is an amount that has been estimated to provide scope to undertake short-term borrowing in the event of a service delivery failure or emergency, e.g. a failure to collect council tax income.

1.5 Forecast Treasury Position

Table 5 shows the expected balances for investments and debt at 31st March 2016.

Table 5 Forecast Treasury Position

At 31st March	2015/16 Estimate £M	2015/16 Revised £M
Debt (Long-Term External Borrowing)	6.3	2.3
Investments	8.4	5.9

The Council has not undertaken any new external long-term borrowing as it is funding capital expenditure with internal borrowing (see Section 3 of the report).

The forecast investments position has been updated to reflect the latest changes to the movements in reserves, provisions and capital expenditure. The reduction in the level of investments at the 31st March from £8.4M to £5.9M is a consequence of the decision to fund capital expenditure from internal borrowing (see line 1 of Table 3).

1.6 Forecast Interest

Table 6 shows the impact on the revenue budget of interest payable and investment income.

Table 6 Forecast Interest

Revenue Budget	2015/16 Estimate £M	2015/16 Revised £M
Interest payable on Borrowing	0.22	0.07
Investment Income	0.03	0.05

The interest payable budget will be revised to incorporate the savings generated by using internal borrowing to fund capital expenditure. The interest receivable budget will be revised to incorporate a combination of higher cash balances and improved investment returns.

1.7 Adoption of the CIPFA Treasury Management Code

The Council approved the adoption of the CIPFA Treasury Management Code at its meeting on 1st December 2003, and adopted the revised Code on 1st March 2010.

1.8 Limits on Interest Rate Exposure

These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates.

Table 7 Interest Rate Exposures

	2015/16 Original Indicator £M	2015/16 Revised Indicator £M
Limits on fixed rate debt	6.30	2.30
Limit on variable rate debt (50% of total debt)	3.15	1.15

The limits have decreased as the Council is able to fund the capital borrowing requirement with internal borrowing and does not expect to request new external borrowing during 2015/16.

1.9 Ratio of Financing Costs to Net Revenue Stream

This indicator identifies the trend in the financing cost (interest payable less interest receivable) as a percentage of the net revenue stream as shown in Table 8.

Table 8 Ratio of Financing Costs to Net Revenue Stream

	2015/16 Original Indicator	2015/16 Revised Indicator
Ratio	8.9%	7.1%

Financing costs are based on the amount of interest payable and receivable as a percentage of the total net revenue stream of the Council. The latest estimate is lower than the original estimate due to the current treasury strategy of internal borrowing rather than long-term external borrowing, which has reduced estimated debt interest charges and an improved return on investment income.