Rotherham Metropolitan Borough Council

Public Report

Summary Sheet

Council Report
Audit Committee

Title
Mid-Year Treasury Management and Prudential Indicators Monitoring Report – 2016/17

Is this a Key Decision and has it been included on the Forward Plan?
No

Strategic Director Approving Submission of the Report
Judith Badger – Strategic Director for Finance & Customer Services

Report Author(s)
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Ward(s) Affected
All

Executive Summary

1. Mid-Year Treasury Review

The regulatory framework of treasury management requires that the Council receive a mid-year treasury review, in addition to the forward looking annual treasury strategy and backward looking annual treasury report required previously.

This report meets the first of those requirements. It also incorporates the needs of the Prudential Code to ensure adequate monitoring of the capital expenditure plans and the Council's prudential indicators (PIs).

It is a requirement that changes to the prudential indicators for 2016/17 are approved by Full Council.

The monitoring as set out in the Appendix to the report is structured to highlight the key changes to the Council's capital activity (the PIs) and the actual and proposed treasury management activity (borrowing and investment).

A technical and complex report, the key messages for Members are:

a. Investments - the primary governing principle remains **security** over return and the criteria for selecting counterparties continues to reflect this.

b. Borrowing - overall this will remain fairly constant over the period covered by this report and the Council will remain under-borrowed against the borrowing requirement due to the cost of carrying debt. New borrowing will generally only be taken up as debt matures. This is in line with financial planning assumptions.

c. Governance - strategies and monitoring are undertaken by Audit Committee

Recommendations

The Audit Committee is asked to:

1. **Note the contents of the report; and**

2. **Refer the report to Cabinet and Commissioners Decision Making meeting to consider recommending Council approve the changes to the 2016/17 prudential indicators.**

List of Appendices Included
Appendix – Mid-Year Treasury Management and Prudential Indicators Monitoring Report – 2016/17

Background Papers
None

Consideration by any other Council Committee, Scrutiny or Advisory Panel
No

Council Approval Required
Yes

Exempt from the Press and Public
No

Mid-Year Treasury Management and Prudential Indicators Monitoring Report – 2016/17

1. Recommendations

The Audit Committee is asked to:

1. **Note the contents of the report; and**

2. **Refer the report to Cabinet and Commissioners Decision Making meeting to consider recommending Council approve the changes to the 2016/17 prudential indicators.**

2. Background

2.1 **Mid-Year Treasury Review** – Revisions to the regulatory framework of treasury management during 2009 introduced a requirement that the Council receive a mid-year treasury review, in addition to the forward looking annual treasury strategy and backward looking annual treasury report required previously.

2.2 This review as fully set out in the Appendix meets that revised requirement. It also incorporates the needs of the Prudential Code to ensure adequate monitoring of the capital expenditure plans and the Council's prudential indicators (PIs). The Treasury Strategy and PIs were previously reported to Audit Committee and Cabinet and Commissioners Decision Making meeting in February 2016 and approved by Council on 2 March 2016.

3. Key Issues

3.1 **Mid-Year Treasury Review** – The review as set out in the Appendix keeps Members up to date and informs on performance against the plan.

3.2 The key messages for Members are:

a. Investments - the primary governing principle remains **security** over return and the criteria for selecting counterparties continues to reflect this.

b. Borrowing - overall this will remain fairly constant over the period covered by this review and the Council will remain under-borrowed against the borrowing requirement due to the cost of carrying debt. New borrowing will generally only be taken up as debt matures.

c. Governance - strategies and monitoring are undertaken by Audit Committee

4. Options considered and recommended proposal

4.1 **Mid-Year Treasury Review** – The review as set out in the Appendix indicates performance is in line with the plan and no proposals to vary the approach for the remainder of the year are proposed.

5. Consultation

5.1 The continuing approach to treasury management has been discussed with the Council's External Treasury Management Advisers Capita Asset Services, who have confirmed this is a prudent approach given current market conditions.

6. Timetable and Accountability for Implementing this Decision

6.1 Approval of the changes to the Prudential Indicators to be made in line with the Council's constitution.

7. Financial and Procurement Implications

7.1 Treasury Management forms an integral part of the Council's overall financial arrangements.

7.2 The assumptions supporting the capital financing budget for 2016/17 and for future years covered by the Council's MTFS were reviewed in light of economic and financial conditions and the capital programme.

7.3 At this stage the Treasury Management and Investment Strategy is not forecast to have any further revenue consequences other than those identified and planned for in both the Council's 2016/17 Revenue Budget and updated approved MTFS.

8. Legal Implications

8.1 It is a requirement that changes to the Council's prudential indicators and approved by Full Council

9. Human Resources Implications

9.1 There are no Human Resource implications arising from the report.

10. Implications for Children and Young People and Vulnerable Adults

10.1 There are no implications arising from the proposals to Children and Young People and Vulnerable Adults.

11. Equalities and Human Rights Implications

11.1 There are no implications arising from this report to Equalities and Human Rights.

12. Implications for Partners and Other Directorates

12.1 There are no implications arising from this report to Partners or other directorates.

13. Risks and Mitigation

13.1 Regular monitoring of treasury activity ensures that risks and uncertainties are addressed at an early stage and hence kept to a minimum.

14. Accountable Officer(s)

Derek Gaffney (Chief Accountant)
Stuart Booth (Assistant Director, Financial Services)

Approvals Obtained from:-

Strategic Director for Finance & Customer Services:- Judith Badger

Appendix

Mid-Year Prudential Indicators and Treasury Management Monitoring

1. Introduction and Background

1.1 Revisions to the regulatory framework of treasury management during 2009 introduced a requirement that the Council receive a mid-year treasury review, in addition to the forward looking annual treasury strategy and backward looking annual treasury report required previously.

1.2 This report meets that revised requirement. It also incorporates the needs of the Prudential Code to ensure adequate monitoring of the capital expenditure plans and the Council's prudential indicators (PIs). The Treasury Strategy and PIs were previously reported to Audit Committee and Commissioners Decision Making meeting in February 2016 and approved by Council on 2 March 2016.

1.3 The Council's revised capital expenditure plans (Section 2.2 of this Appendix) and the impact of these revised plans on its financing are set out in Section 2.3. The Council's capital spend plans provide a framework for the subsequent treasury management activity. Section 3 onwards sets out the impact of the revised plans on the Council's treasury management indicators.

1.4 The underlying purpose of the report supports the objective in the revised CIPFA Code of Practice on Treasury Management and the Communities & Local Government Investment Guidance. These state that Members receive and adequately scrutinise the treasury management service.

1.5 The underlying economic and financial environment remains difficult for the Council, foremost being the improving, but still challenging, concerns over investment counterparty risk. This background encourages the Council to continue maintaining investments short term and with high quality counterparties. The downside of such a policy is that investment returns remain low.

1.6 The Strategic Director for Finance & Customer Services can report that the basis of the treasury management strategy, the investment strategy and the PIs are not materially changed from that set out in the approved Treasury Management Strategy (March 2016).

2. Key Prudential Indicators

2.1. This part of the report is structured to update:

- The Council's latest capital expenditure plans;
- How these plans are being financed;
- The impact of the changes in the capital expenditure plans on the PIs and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity.

2.2 **Capital Expenditure (PI)**

2.2.1 This table shows the forecast estimates for capital expenditure as reported in the September Financial Monitoring Report presented to the Cabinet and Commissioners' Decision Making meeting held on the 14 November 2016.

Capital Expenditure by Service	2016/17 Original Estimate £m	2016/17 Revised Estimate £m
Children & Young People Services	4.726	8.209
Regeneration & Environment	21.465	15.831
Adult Care & Housing – Non-HRA	5.013	4.664
Finance & Customer Services	4.108	2.783
Total Non-HRA	**35.312**	**31.487**
Adult Care & Housing – HRA	32.992	26.909
Total HRA	**32.992**	**26.909**
Total	**68.304**	**58.396**

2.3 **Impact of Capital Expenditure Plans**

2.3.1 **Changes to the Financing of the Capital Programme**

The table below draws together the main strategy elements of the capital expenditure plans (above), highlighting the expected financing arrangements of this capital expenditure.

Capital Expenditure	2016/17 Original Estimate £m	2016/17 Revised Estimate £m
Total spend	68.304	58.396
Financed by:		
Capital receipts	5.746	2.409
Capital grants, capital contributions & other sources of capital funding	44.691	43.550
Borrowing Need	17.867	12.437
Total Financing	**68.304**	**58.396**
Unsupported Borrowing	17.867	12.437
Borrowing Need	**17.867**	**12.437**

The borrowing element of the table increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision (MRP)). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

2.3.2 The decrease in borrowing need for 2016/17 reflects the re-profiling of capital expenditure & financing and new approvals since the original estimate was approved (£5.430m).

2.3.3 **Changes to the Capital Financing Requirement (PI), External Debt and the Operational Boundary (PI)**

The table below shows the CFR, which is the underlying external need to borrow for a capital purpose. It also shows the expected debt position over the period. This is termed the Operational Boundary which was set at the beginning of the financial year at £628.393m.

2.3.4 **Prudential Indicators – Capital Financing Requirement & External Debt / the Operational Boundary**

In addition to showing the underlying need to borrow, the Council's CFR has since 2009/10, also included other long term liabilities which have been brought on balance sheet, for example, PFI schemes and finance lease assets. No borrowing is actually required against these schemes as a borrowing facility is already included in the contract. The estimate for 2016/17 does not require any revision as there is no change in the borrowing need from such arrangements.

2.3.5 The revised CFR estimate for 2016/17 is £797.150m and this figure represents an increase of £9.903m when compared to the 2015/16 year-end position of £787.247m. The increase is due to:

- The estimated borrowing need for the year (£12.430m) net of the Minimum Revenue Provision charge for the year (£0.347m)
- The repayments of borrowing contained within PFI and similar schemes (£2.187m).

RMBC	2016/17 Original Estimate £m	Current Position £m	2016/17 Revised Estimate £m
Prudential Indicator – Capital Financing Requirement			
CFR – Non Housing	363.529		357.470
CFR – Housing	304.125		304.125
Total CFR excluding PFI, finance leases and similar arrangements	667.654		661.595
Net movement in CFR	17.480		12.090
Cumulative adjustment for PFI, finance leases and similar arrangements	135.434		135.555
Net movement in CFR	-2.154		-2.187
Total CFR including PFI, finance leases and similar arrangements	803.088		797.150
Net movement in overall CFR	15.326		9.903
Prudential Indicator – External Debt / the Operational Boundary			
Borrowing	490.805	460.453	483.132
Other long term liabilities*	137.588	136.646	135.555
Total Debt 31 March	628.393	597.099	618.687

* - Includes on balance sheet PFI schemes, finance leases and similar arrangements, etc.

Former SYCC	2016/17 Original Estimate £m	Current Position £m	2016/17 Revised Estimate £m
Prudential Indicator – External Debt / the Operational Boundary			
Borrowing	86.709	86.709	86.709
Other long term liabilities	0	0	0
Total Debt 31 March	86.709	86.709	86.709

3. Limits to Borrowing Activity

3.1 The first key controls over the treasury activity is a PI to ensure that over the medium term, gross and net borrowing will only be for a capital purpose. Gross and net external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2016/17 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which would only be adhered to if this proves prudent to do so.

RMBC	2016/17 Original Estimate £m	Current Position £m	2016/17 Revised Estimate £m
Gross Borrowing	490.805	460.453	483.132
Plus Other Long Term liabilities*	135.434	136.646	135.555
Total Gross Borrowing	626.239	597.099	618.687
CFR*	803.088	792.196	797.150
Total Gross Borrowing	626.239	597.099	618.687
Less Investments	20.000	11.280	20.000
Net Borrowing	606.239	585.819	598.687
CFR*	803.088	792.196	797.150

* - Includes on balance sheet PFI schemes, finance leases and similar arrangements, etc.

3.2 The Strategic Director for Finance & Customer Services reports that no difficulties are envisaged for the current or future years in complying with this PI.

3.3 A further PI controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Authorised limit for external debt (RMBC)	2016/17 Original Indicator £m	Current Position £m	2016/17 Revised Indicator £m
Borrowing	698.201	460.453	700.700
Other long term liabilities*	137.588	136.646	137.588
Total	835.789	597.099	838.288

* - Includes on balance sheet PFI schemes, finance leases and similar arrangements, etc.

Authorised limit for external debt (Former SYCC)	2016/17 Original Indicator £m	Current Position £m	2016/17 Revised Indicator £m
Borrowing	86.709	86.709	86.709
Other long term liabilities	0.000	0.000	0.000
Total	86.709	86.709	86.709

4. Treasury Strategy 2016/17 – 2018/19

4.1 Debt Activity during 2016/17

4.1.1 The expected borrowing need is set out below:

RMBC	2016/17 Original Estimate £m	Current Position £m	2016/17 Revised Estimate £m
CFR	808.088	792.196	797.150
Less Other Long Term Liabilities*	135.434	136.646	135.555
Net Adjusted CFR (y/e position)	667.654	655.550	661.595
Borrowed at 30/09/16	463.453	460.453	460.453
Under borrowing at 30/09/16	204.201	195.097	201.142
Borrowed at 30/09/16	463.453		460.453
Estimated to 31/03/17	27.352		22.679
Total Borrowing	490.805		483.132
Under borrowing at 31/03/17	176.849		178.463

* - Includes on balance sheet PFI schemes, finance leases and similar arrangements, etc.

4.1.2 The Council is currently under-borrowed and the delay in borrowing reduces the cost of carrying the borrowed monies when yields on investments are low relative to the borrowing rates. Based on current borrowing rates and investment returns the differential is around 2% and if the Council was fully borrowed the additional cost per year would amount to approximately £3.5m. The delay in borrowing gives rise to interest rate risk, as longer term borrowing rates may rise, but this position is being closely monitored and the overall position carefully managed.

4.1.3 During the six months to 30 September 2016 the Council has borrowed the following amount:

Principal	Type	Term	Interest Rate
£10,000,000	Fixed Rate	5 Years	1.05%

4.1.4 During the six months to 30 September 2016, the Council has repaid the following amounts:

Lender	Principal	Type	Interest Rate
PWLB	£10,000,000	Variable rate	0.69%
PWLB	£5,000,000	Fixed rate	2.18%
PWLB	£1,000,000	Fixed rate (EIP)	3.46%
PWLB	£65,000	Fixed rate (EIP)	3.79%
PWLB	£80,225	Fixed rate (Annuity)	Various

One Equal Instalment of Principal (EIP) loan for £20m is being repaid in equal half yearly instalments of £1m over its 10 year term. A second EIP loan for £1.3m is being repaid in equal half yearly instalments of £65,000 over its 10 year term. There are 5 Annuity loans on which variable amounts of principal are repaid each six months.

4.1.5 During the six months to 30 September 2016, the Council had the "unexpected" opportunity to restructure the following LOBO loans with Siemens Financial Services:

One loan of £10m with an interest rate of 3.22% and maturity date in June 2021 has been fully repaid. This has been refinanced by taking out the equivalent PWLB loan referred to at 4.1.3.

The second Siemens loan of £10m with an interest rate of 3.14% and maturity date in April 2026 has been restructured to £10m with an interest rate of 2.66% and maturity date in September 2031.

Over the next five years the effect of this restructuring will save the Council £1.325m in interest costs and this has been included in current year's revenue monitoring and longer-term financial plans.

4.1.6 In June 2016 Council was informed by Barclays Bank that it has given up its right to amend the loan rates on the Council's LOBO loans at any point up to maturity. The interest rates on these loans totalling £62m are therefore now fixed and the risk of rates increasing in future has been removed.

4.1.7 As a result of the restructuring referred to at 4.1.5 and the unilateral change made by Barclays the Council's total LOBO loans at risk of future interest rate increases now amounts to £141m compared to the £213m at the start of the financial year and risk exposure to longer term interest rate rises has been diminished significantly.

5. Investment Strategy 2016/17 – 2018/19

5.1 Key Objectives

The primary objective of the Council's investment strategy is safeguarding the repayment of the principal and interest of its investments on time – the investment return being a secondary objective. The current difficult economic and financial climate has heightened the Council's over-riding risk consideration with regard to "Counterparty Risk". As a result of these underlying market concerns officers continue to implement an operational investment strategy which further tightens the controls already in place in the approved investment strategy.

5.2 Current Investment Position

The Council held £11.280m of investments at 30 September 2016 (excluding Icelandic Banks), and the constituent parts of the investment position are:

Sector	Country	Up to 1 year £m	1 - 2 years £m	2 – 3 years £m
Banks	UK	4.500	0	0
DMO	UK	6.780	0	0
Local Authorities	UK	0	0	0
Total		11.280	0	0

One 'call' account with the top rated bank Handlesbanken is operated. This bank meets the Council's highest investment criteria.

This enables the Council to minimise the risk of having to leave unexpected receipts with the Council's current bankers, it allows immediate access to a small amount of funds to cover or part cover any short-term borrowing requirements and based on current rates there is a small benefit of approx. 0.05% over the rate achievable from the Debt Management Office.

5.3 Risk Benchmarking

A regulatory development is the consideration and approval of security and liquidity benchmarks. Yield benchmarks are currently widely used to assess investment performance. Discrete security and liquidity benchmarks are requirements to Member reporting and the following reports the current position against the benchmarks.

5.3.1 **Security** – The Council monitors its investments against historic levels of default by continually assessing these against the minimum criteria used in the investment strategy. The Council's approach to risk, the choice of

counterparty criteria and length of investment ensures any risk of default is minimal when viewed against these historic default levels.

5.3.2 **Liquidity** – In respect of this area the Council set liquidity facilities/benchmarks to maintain:

- Bank overdraft – on a day-to-day basis the Council works to an agreed overdraft limit of £100,000 with the Council's bankers. Whilst a short-term increase could be negotiated less expensive short-term borrowing is accessed through the financial markets to remain within the agreed overdraft.
- Liquid short-term deposits of at least £3m available within a week's notice.

The Strategic Director for Finance & Customer Services can report that liquidity arrangements were adequate during the year to date.

5.3.3 **Yield** – a local measure for investment yield benchmark is internal returns above the 7 day LIBID rate

The Strategic Director for Finance & Customer Services can report that the return to date averages 0.20%, against a 7 day LIBID to the end of September 2016 of 0.28%. This is reflective of the Council's current approach to risk whereby security has been maximised by using the Debt Management Office and other Local Authorities as the principal investment counterparties.

It is important to recognise that based on the Council's current average cash investments of £14m the difference in return at the benchmark when compared to the return achieved at the current rate would be £11.2k. This increase in return has to be measured against the additional risk of placing cash elsewhere.

6. Revisions to the Investment Strategy

6.1 The counterparty criteria are continually under regular review but in the light of the current market conditions no recommendations are being put to Members to revise the Investment Strategy.

7. Treasury Management Prudential Indicators

7.1 Actual and estimates of the ratio of financing costs to net revenue stream

This indicator identifies the trend in the cost of capital (financing costs net of interest and investment income) against the net revenue stream.

	2016/17 Original Indicator %	2016/17 Revised Indicator %
Non-HRA	6.46	5.93
HRA	16.43	15.98

7.2 The revised non HRA indicator reflects the impact of the restructured debt and borrowing being at rates less than originally anticipated for 2016/17. The HRA indicator has also decreased due to the HRA's internal borrowing, which is calculated using the Council's overall average rate of interest, now being at a lower rate than that which had been assumed in the original indicator.

7.3 **Prudential indicator limits based on debt net of investments**

- **Upper Limits On Fixed Rate Exposure** – This indicator covers a maximum limit on fixed interest rates.

- **Upper Limits On Variable Rate Exposure** – Similar to the previous indicator this identifies a maximum limit for variable interest rates based upon the debt position net of investments.

RMBC	2016/17 Original Indicator	Current Position	2016/17 Revised Indicator
Prudential indicator limits based on debt net of investments			
Limits on fixed interest rates based on net debt	100%	84.70%	100%
Limits on variable interest rates based on net debt	30%	14.93%	30%

7.4 **Maturity Structures Of Borrowing**

These gross limits are set to reduce the Council's exposure to large fixed rate loans (those instruments which carry a fixed interest rate for the duration of the instrument) falling due for refinancing.

The current position shown below reflects the next call dates on those Council's LOBO loans (£132m) that are not callable in 2016/17 and thus are regarded as fixed rate. The actual maturity date for most of these loans is greater than 50 years. This approach gives a better indication of risk and whilst there is a possibility that a loan is called with an increase in interest payable the likelihood of any LOBO loans being called in the current climate is assessed as zero for the next three years.

RMBC	2016/17 Original Indicator		Current Position		2016/17 Revised Indicator	
	Lower	Upper	%	£m	Lower	Upper
Maturity Structure of fixed borrowing						
Under 12 months	0%	35%	0.29%	1.147	0%	35%
12 months to 2 years	0%	35%	5.73%	22.299	0%	35%
2 years to 5 years	0%	40%	18.47%	71.938	0%	40%
5 years to 10 years	0%	40%	25.44%	99.069	0%	40%
10 years to 20 years	0%	45%	8.67%	12.914	0%	45%
20 years to 30 years	0%	50%	14.47%	33.750	0%	50%
30 years to 40 years	0%	50%	14.47%	56.336	0%	50%
40 years to 50 years	0%	55%	13.35%	52.000	0%	55%
50 years and above	0%	60%	10.27%	40.000	0%	60%

The former SYCC account is due to be wound up by the end of 2020/21 and the maturity structure is now largely fixed as the need and indeed opportunities to re-finance within the remaining 5 years will be limited. As a result future limits are currently set in line with the on-going maturity profile.

Former SYCC	2016/17 Original Indicator		Current Position		2016/17 Revised Indicator	
	Lower	Upper	%	£m	Lower	Upper
Maturity Structure of fixed borrowing						
Under 12 months	0%	25%	11.53%	10.000	0%	25%
12 months to 2 years	0%	50%	45.80%	39.709	0%	50%
2 years to 5 years	0%	100%	42.67%	37.000	0%	100%

7.5 **Total Principal Funds Invested**

These limits are set to reduce the need for the early sale of an investment, and show limits to be placed on investments with final maturities beyond each year-end.

The Council currently has no sums invested for periods exceeding 364 days due to market conditions. To allow for any changes in those conditions the indicator has been left unchanged. This also excludes any Icelandic investments that are due to be recovered after more than 364 days.

RMBC	2016/17 Original Indicator £m	Current Position £m	2016/17 Revised Indicator £m
Maximum principal sums invested > 364 days	10	0	10
Comprising			
Cash deposits	10	0	10

7.6 **Treasury Management Advisers**

The Council's three year contract for the provision of treasury management and asset finance services expired on 6 October 2016.

In accordance with the Council's Standing Orders, a tendering exercise was carried out for the re-procurement of these services for a further three year period.

An open tender exercise was held from which two submissions were received – one from Capita Asset Services Treasury Solutions and a second from Arlingclose.

These were evaluated on quality and price with Capita Asset Services Treasury Solutions bid ranking slightly higher on both criteria.

Accordingly, a decision has been taken to re-appoint Capita Asset Services Treasury Solutions for a further term of three years with effect from 7 October 2016.