ROTHERHAM BOROUGH COUNCIL – REPORT TO AUDIT COMMITTEE

1.	**Meeting:**	**Audit Committee**
2.	**Date:**	**19 November 2014**
3.	**Title:**	**Mid Year Treasury Management and Prudential Indicators Monitoring Report 2014/15**
4.	**Directorate:**	**Resources**

5. Summary

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 that 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 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 reflects 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.

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

6. Recommendations

The Audit Committee is asked to:

1. **Note the report and the treasury activity; and**
2. **Refer the report to Cabinet to consider recommending Council approve the changes to the 2014/15 prudential indicators**.

7. Proposals and Details

The Director of Financial Services has delegated authority to carry out treasury management activities on behalf of the Council and this report is produced in order to comply with the CIPFA Code of Practice in respect of Treasury Management in Local Authorities and the “Prudential Code”.

8. Finance

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

The assumptions supporting the capital financing budget for 2014/15 and for future years covered by the Council’s MTFS were reviewed in light of economic and financial conditions and the future years’ capital programme.

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 2014/15 Revenue Budget and approved MTFS.

9. Risks and Uncertainties

Regular monitoring will ensure that risks and uncertainties are addressed at an early stage and hence kept to a minimum.

10. Policy and Performance Agenda Implications

Effective treasury management will assist in delivering the Council’s policy and performance agenda.

11. Background Papers and Consultation

CIPFA Code of Practice for Treasury Management in Local Authorities
Local Government Act 2003
CIPFA “Prudential Code”

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Appendix

Mid Year Prudential Indicators and Treasury Management Monitoring Report

1. Introduction and Background to the Report

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 Cabinet in February 2014 and approved by Council on 5 March 2014.

1.3 The Council's revised capital expenditure plans (Section 2.2 of this report) 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 CLG 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 Director of Financial 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 2014).

2. Key Prudential Indicators

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

- The Council's 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 **<u>Capital Expenditure (PI)</u>**

2.2.1 This table shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the Budget. The revised estimate reflects the latest position in the 2014/15 capital monitoring report presented to Cabinet on 24 September 2014

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Capital Expenditure by Service	2014/15 Original Estimate £m	2014/15 Revised Estimate £m
Children & Young People's Services	10.948	12.034
Environmental & Development Services	14.239	29.400
Neighbourhoods & Adult Services – Non-HRA	3.156	5.094
Resources	0.957	3.179
Total Non-HRA	**29.300**	**49.707**
Neighbourhoods & Adult Services – HRA	30.048	32.006
Total HRA	**30.048**	**32.006**
Total	**59.348**	**81.713**

2.3 **<u>Impact of Capital Expenditure Plans</u>**

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	2014/15 Original Estimate £m	2014/15 Revised Estimate £m
Total spend	59.348	81.713
Financed by:		
Capital receipts	0.782	2.414
Capital grants, capital contributions & other sources of capital funding	50.967	63.264
Borrowing Need	7.599	16.035
Total Financing	**59.348**	**81.713**
Supported Borrowing	0.000	0.000
Unsupported Borrowing	7.599	16.035
Borrowing Need	**7.599**	**16.035**

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 It was reported to Audit Committee in September 2014 that actual capital expenditure financed by borrowing in 2013/14 was less than had been anticipated (£3.899m). The increase in borrowing need for 2014/15 therefore reflects the re-profiling of this project expenditure & financing from 2013/14 and new approvals since the original estimate was approved (£4.932m). The main areas of slippage in 2013/14 were Investment in ICT and Highways Projects. Since the original estimate for borrowing need was approved, further capital projects have been approved which are to be financed in part or wholly by borrowing and these include the purchase of business units at the Advanced Manufacturing Park and support to the BD UK broadband project.

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 £614.912m.

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 2014/15 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 2014/15 is £755.262m and this figure represents an increase of £5.812m when compared to the 2013/14 year-end position of £749.450m. The increase is principally due to the value of the new approvals (£4.932m) within the increased borrowing need for 2014/15 (see 2.3.2 above). A reduction in the MRP charge for 2013/14 and the marginally higher outturn borrowing amount contained within PFI and similar schemes at 31st March 2014 also contribute due to the effect these had on the 2013/14 year-end CFR.

RMBC	2014/15 Original Estimate £m	Current Position £m	2014/15 Revised Estimate £m
Prudential Indicator – Capital Financing Requirement			
CFR – Non Housing	316.593		320.734
CFR – Housing	307.646		306.961
Total CFR excluding PFI, finance leases and similar arrangements	624.239		627.695
Net movement in CFR	-2.803		5.812
Cumulative adjustment for PFI, finance leases and similar arrangements	125.617		127.567
Net movement in CFR	-1.788		0.000
Total CFR including PFI, finance leases and similar arrangements	749.856		755.262
Net movement in overall CFR	-4.591		5.812
Prudential Indicator – External Debt / the Operational Boundary			
Borrowing	487.507	479.024	479.695
Other long term liabilities*	127.405	127.567	127.567
Total Debt 31 March	614.912	606.591	607.262

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

Former SYCC	2014/15 Original Estimate £m	Current Position £m	2014/15 Revised Estimate £m
Prudential Indicator – External Debt / the Operational Boundary			
Borrowing	96.121	96.121	96.121
Other long term liabilities	0	0	0
Total Debt 31 March	96.121	96.121	96.121

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 2014/15 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 will be adhered to if this proves prudent to do so.

RMBC	2014/15 Original Estimate £m	Current Position £m	2014/15 Revised Estimate £m
Gross Borrowing	487.507	479.024	479.695
Plus Other Long Term liabilities*	127.405	127.567	127.567
Total Gross Borrowing	614.912	606.591	607.262
CFR*	749.856	752.356	755.262
Total Gross Borrowing	614.912	606.591	607.262
Less Investments	10.000	32.540	25.000
Net Borrowing	604.912	574.051	582.262
CFR*	749.856	752.356	755.262

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

3.2 The Director of Financial 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)	2014/15 Original Indicator £m	Current Position £m	2014/15 Revised Indicator £m
Borrowing	637.971	479.024	643.023
Other long term liabilities*	127.405	127.567	127.567
Total	765.376	606.591	770.590

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

Authorised limit for external debt (Former SYCC)	2014/15 Original Indicator £m	Current Position £m	2014/15 Revised Indicator £m
Borrowing	96.121	96.121	96.121
Other long term liabilities	0.000	0.000	0.000
Total	96.121	96.121	96.121

4. Treasury Strategy 2014/15 – 2016/17

4.1 Debt Activity during 2014/15

4.1.1 The expected borrowing need is set out below:

RMBC	2014/15 Original Estimate £m	Current Position £m	2014/15 Revised Estimate £m
CFR	749.856	752.356	755.262
Less Other Long Term Liabilities*	125.617	127.567	127.567
Net Adjusted CFR (y/e position)	624.239	624.789	627.695
Borrowed at 30/09/14	494.368	479.024	479.024
Under borrowing at 30/09/14	129.871	145.765	148.671
Borrowed at 30/09/14	494.368		479.024
Estimated to 31/03/15	-9.944		0.671
Total Borrowing	484.424		479.695
Under borrowing at 31/03/15	139.815		148.000

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

4.1.2 The Council is currently under-borrowed. The delay in borrowing reduces the cost of carrying the borrowed monies when yields on investments are low relative to borrowing rates. There is also an 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 In late 2013/14 arrangements were made through a forward deal to borrow £20m in 2014/15 from the pension fund of BAE Systems. This was on the anticipation of maturities in the year principally £25m to be repaid in December 2014. During the six months to 30 September 2014 the Council was in receipt of £4m of that sum with the remaining £16m due to be received in December. The rate of interest on this debt is 4.05% and loan period is 44 years.

4.1.4 During the six months to 30 September 2014, the Council has repaid the following amounts:

Lender	Principal	Type	Interest Rate
PWLB	£1,000,000	Fixed rate (EIP)	3.46%
PWLB	£65,000	Fixed rate (EIP)	3.79%
PWLB	£74,074	Fixed rate (Annuity)	Various

One 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 There has been no restructuring or early repayment of existing debt in the first six months of 2014/15.

5. Investment Strategy 2014/15 – 2016/17

5.1 Key Objectives

The primary objective of the Council's investment strategy is the 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 £32.540m of investments at 30 September 2014 (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	0	0	0
DMO	UK	17.040	0	0
Local Authorities	UK	15.500	0	0
Total		32.540	0	0

Officers are currently arranging for the opening of a 'call' account with the top rated bank Handlesbanken. This bank meets the Council's highest investment criteria and any deposits will in the short-term be limited to a maximum period of 1 month and a maximum amount of £1m.

This approach will enable the Council to minimise the risk of having to leave unexpected receipts with the Council's current and future bankers, it will allow immediate access to a small amount of funds to cover or part cover any short-term borrowing requirements and based on current rates there would be a small benefit of currently approx. 0.2% 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 new requirements to the Member reporting.

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:

- A Bank overdraft facility of £10m
- Liquid short-term deposits of at least £3m available within a week's notice.

The Director of Financial 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 Director of Financial Services can report that the return to date averages 0.25%, against a 7 day LIBID to end September 2014 of 0.35%. 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.

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.

	2014/15 Original Indicator %	2014/15 Revised Indicator %
Non-HRA	9.14	8.68
HRA	17.52	17.29

7.2 The revised non HRA indicator reflects the impact of borrowing being at rates less than originally anticipated for 2014/15. The HRA indicator has increased slightly due to the final HRA revenue budget being less than that 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	2014/15 Original Indicator	Current Position	2014/15 Revised Indicator
Prudential indicator limits based on debt net of investments			
Limits on fixed interest rates based on net debt	100%	76.26%	100%
Limits on variable interest rates based on net debt	30%	22.13%	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 (£106m) that are not callable in the next 12 months and thus regarded as fixed rate rather than their actual maturity date which for most of these loans is beyond 50 years (£82m). 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	2014/15 Original Indicator		Current Position		2014/15 Revised Indicator	
	Lower	Upper	%	£m	Lower	Upper
Maturity Structure of fixed borrowing						
Under 12 months	0%	35%	5.67%	21.141	0%	35%
12 months to 2 years	0%	35%	11.34%	42.286	0%	35%
2 years to 5 years	0%	40%	23.30%	86.896	0%	40%
5 years to 10 years	0%	40%	21.51%	80.246	0%	40%
10 years to 20 years	0%	45%	5.81%	21.690	0%	45%
20 years to 30 years	0%	50%	9.23%	34.430	0%	50%
30 years to 40 years	0%	50%	8.18%	30.521	0%	50%
40 years to 50 years	0%	55%	14.96%	55.815	0%	55%
50 years and above	0%	60%	0%	0.000	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 7 years will be limited. As a result future limits are currently set in line with the on-going maturity profile.

Former SYCC	2014/15 Original Indicator		Current Position		2014/15 Revised Indicator	
	Lower	Upper	%	£m	Lower	Upper
Maturity Structure of fixed borrowing						
Under 12 months	0%	50%	0.00%	0.000	0%	50%
12 months to 2 years	0%	70%	9.79%	9.412	0%	70%
2 years to 5 years	0%	100%	52.56%	50.520	0%	100%
5 years to 10 years	0%	100%	37.65%	36.189	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. The above also excludes any Icelandic investments that are due to be recovered after more than 364 days.

RMBC	2014/15 Original Indicator £m	Current Position £m	2014/15 Revised Indicator £m
Maximum principal sums invested > 364 days	10	0	10
Comprising			
Cash deposits	10	0	10