

DERBYSHIRE COUNTY COUNCIL

CABINET

14 September 2017

Report of the Director of Finance & ICT

TREASURY MANAGEMENT
(COUNCIL SERVICES)

1 Purpose of the Report

To report on Treasury Management activities during the last financial year 2016-2017 and to indicate the Council's compliance with the prudential indicators set by Full Council at its meeting of 10 February 2016, in accordance with the terms of the Prudential Code for Capital Finance in Local Authorities.

2 Information and Analysis

(i) Introduction

In April 2002, the County Council adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services Code of Practice (the CIPFA Code). The latest revision of the Code in 2011 was subsequently approved by Council. The Code requires the Authority to approve a treasury management annual report after the end of each financial year. The report fulfils the Authority's legal obligation to have regard to the CIPFA code.

The County Council's treasury management strategy for 2016-17 was approved by Full Council on 10 February 2016. The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk is therefore central to the Authority's treasury management strategy.

(ii) Economic

The United Kingdom (UK) referendum on 23 June 2016 resulted in a vote to leave the European Union (EU) by 52% in favour to 48% against.

The Bank of England's Monetary Policy Committee (MPC) cut the Bank Rate (Base Rate) from 0.50% to 0.25% on 4 August 2016.

Quantitative Easing (QE) was increased from £375 billion to £435 billion. Corporate Bond purchases of £10 billion and Term Funding Scheme for banks were also introduced.

Inflation - Consumer Price Inflation (CPI) rose from 0.3% in April 2016 to 2.3% in March 2017 due to a combination of falling Sterling and rising energy prices.

Growth - Gross Domestic Product (GDP) was resilient at 1.9% Year-on-Year.

Employment - The International Labour Organisation (ILO) unemployment figure fell from 5.5% to 4.7%, its lowest level for 11 years.

USA - Donald Trump was elected the 45th President of the USA on 9 November 2016. The Federal Reserve increased interest rates by 0.25% in March 2017.

Europe - Article 50 triggered on 29 March 2017 with a commitment for the UK to leave the EU in the next two years.

Interest Rates - Short-term interest rates affect the amount of interest received by the Council on its investments (generally less than 1 year). Long-term interest rates will affect the amount of interest to be paid by the Council on its future borrowing (generally greater than 1 year).

Public Works Loan Board (PWLB) - This is a statutory body that allows Local Authorities access to borrowing from the National Loans Fund at rates determined by the Treasury. The PWLB uses the published UK Treasury (gilt-edged) stock yield for the relevant duration plus a margin of 1%. (A gilt is classified as the risk free return rate, as the UK Government is highly unlikely to default on its debt). All of the Council's borrowing from the PWLB is currently at fixed interest rates.

PWLB interest rates	(31-03-2017) %	(31-03-2016) %	Change %
5 Year	1.44	1.80	-0.36
10 Year	2.11	2.46	-0.35
25 Year	2.80	3.32	-0.52
50 Year	2.54	3.13	-0.59

From November 2012, the Government reduced the interest rate by 0.20% on loans from the PWLB for principal local authorities which provide the required information on their plans for long-term borrowing and associated capital spending. The Council met the eligibility criteria to obtain this Certainty Rate.

(iii) Borrowing

Total borrowing remained at all times within the limits approved under the terms of the Prudential Code.

Loans totalling £12.500m were repaid to the PWLB during 2016-17.

No new long term borrowing was taken during 2016-17 as the Council continued to utilise its internal resources in line with its approved strategy.

Temporary borrowing of £55.000m was taken from the D2N2 Local Growth fund. A sum of £14.000m was outstanding at 31 March 2017. Temporary borrowing of £8.000m was taken from Other Local Authorities, all of which was repaid at 31 March 2017.

As a result of the 1997 local government reorganisation, Derby City Council became responsible for a proportion of Derbyshire County Council's debt to reflect the underlying assets transferred from the County Council to the City Council. This 'transferred' debt was serviced by the City Council, but held by the County Council. On 31 March 2017, £26.338m of the County Council's PWLB debt was transferred to the City Council. The County Council no longer holds any PWLB debt on behalf of the City Council.

At 31 March 2017 the total amount of loans outstanding for capital expenditure was £311.519m (nominal value) £316.623m (accounting value). The difference of £5.104m is due to an Effective Interest Rate (EIR) adjustment, whereby the premium incurred on rescheduling previous loans is written off over the duration of the replacement loan).

Debt Charges - 2016-17	£m
Interest Payable	22.891
Minimum Revenue Provision (MRP)	14.291
Total Debt Charges	37.182

The Council's average borrowing rate for external debt for 2016-17 is 3.98%. This compares favourably to the CIPFA benchmarking Local Authority average of 4.06%. Whilst this is only a difference of 0.08%, it equates to income of £0.500m. The cost of internal debt is the interest foregone on investing these funds. The Council's average investment rate for 2016-17 was 0.86%. This also compares favourably to the CIPFA benchmarking local authority investment average return of 0.85%. The Council's weighted average maturity (WAM) on debt at 31 March 2017 was 18.8 years. This is similar to the average WAM of Arlingclose (the Councils Treasury Management advisor) clients of 18.9 years.

(iv) Debt Rescheduling and Early Repayment

In November 2010, the PWLB widened the margin between the repayment rate and new borrowing rate from 0.125% to 1%. This increase significantly reduced the viability of debt rescheduling or early repayment. The Council has not repaid or rescheduled any debt since this amendment, but continues to review the position on a regular basis to take advantage of any opportunities as they arise.

(v) Lending

Short term lending of revenue funds/capital receipts pending their use earned interest of £2.8m in 2016-17. In March 2017 these funds earned an average rate of 0.91%. Short-term and some long term deposits were placed with a number of financial institutions, from the counterparty list approved by Full Council.

The Authority's lending policy is to place security of capital and liquidity ahead of investment return.

Counterparties are constantly monitored and withdrawn from the approved list if they no longer satisfy the Council's criteria.

The Council's investments at 31 March 2017 can be analysed in the following ways:

i) Counterparty Type

Type of Institution	£m	%
Banks	75.062	28.5
Building Societies	1.000	0.4
Money Market & Other Pooled Funds	33.607	12.8
Other Local Authorities	148.516	56.4
Registered Social Providers	5.000	1.9
Total	263.185	100.0

A total of 56% of the Council's investments were to Other Local Authorities. Local Authorities are considered risk free in the short to medium term.

ii) Liquidity

The Council's access to liquidity is shown in the following table which analyses the term remaining on Council lending until maturity date:

Duration	£m	%
Less than 1 month	73.669	28.0
1 to 3 months	10.000	3.8
3 to 6 months	68.000	25.8
6 months to 1 year	87.516	33.3
Over 1 year	24.000	9.1
Total	263.185	100.0

The Authority maintained a liquidity buffer of £30m in 2016-17. This amount will cover the Authorities monthly salaries..

iii) Credit Rating

The following table shows investments split according to the counterparties' credit ratings. Whilst losses from the Council's counterparties are not expected, the table also shows the historic market level of defaults for each credit rating category and an estimate of the Council's maximum exposure to default based on that experience:

Credit Rating	£m	Historic market level of default %	Estimated maximum exposure to default £m
AAA	18.113	0.00%	0.000
AA (UK Gov't Local Authorities)	148.516	0.00%	0.000
AA	5.029	0.03%	0.002
A	80.046	0.06%	0.048
Not rated	11,481	0.17%	0.020
TOTAL	263.185		0.070

(vi) Activity in 2017-18 to date

The Council has received £66.5m of temporary borrowing from the D2N2 Local Enterprise Partnership.

(vii) Prudential Code for Capital Finance & Treasury Management

On 8 February 2017 Full Council approved the Capital Programme, borrowing limits and other prudential indicators for 2017-18. The levels set by Full Council and the outturns for the year 2016-17 are shown in Appendix 1. All Prudential Indicators have been complied with.

(viii) Training

A series of training sessions on financial matters has been suggested for inclusion on the Member Development Groups Training Programme. Treasury Management is included within this programme.

3 Considerations

In preparing this report the relevance of the following factors has been considered: financial, legal, prevention of crime and disorder, equality and diversity, human resources, environmental, health, property, social value and transport considerations.

4 Call-in

Is it required that call-in be waived in respect of the decisions proposed in the report? No.

5 Background Papers

Treasury Management Strategy 2016-17
Papers held in Room 137, Technical Section, Finance & ICT.

6 Officer's Recommendation

That the annual report on Treasury Management for 2016-2017 be noted.

PETER HANDFORD

Director of Finance & ICT

APPENDIX 1

Prudential Code for Capital Finance & Treasury Management

Compliance with Prudential Indicators 2016-17, as approved by Full Council in February 2016.

Capital Expenditure and Capital Financing Requirement

These Indicators show the total capital expenditure and the Capital Financing Requirement (CFR) for the year against the initial estimates approved in January 2016. The CFR is the Council's underlying need to borrow for capital purposes and is therefore dependent on the approved level of capital expenditure.

	2016-17 Estimate Original Jan 16 £m	2016-17 Estimate Revised Jan 17 £m	2016-17 Actual Year End £m
Capital Expenditure	186.920	146.010	110.828
CFR (Capital Financing Requirement)	585.650	517.990	468.670

Capital expenditure was lower than anticipated due to slippage of capital projects (delayed due to unforeseen circumstances) and the repayment of transferred debt by Derby City Council.

The Authorised Limit and the Operational Boundary

The Authorised Limit represents the limit beyond which borrowing is prohibited. This limit would be revised by members if necessary.

The Operational Boundary is an estimate, based upon the probable external debt during the course of the year. As this is not a limit, the actual level of borrowing may exceed this boundary.

Authorised limit for external debt	Authorised Limit for external debt 2016-17 £m	Operational Boundary for external debt 2016-17 £m	Actual external debt 2016-17 £m
Borrowing	536.000	486.000	324.599
PFI & finance leases	79.000	79.000	78.698
Total	615.000	565.000	403.297

The above table shows that at the year end actual debt was comfortably within both the Authorised Limit and the Operational Boundary. At no stage during the year did external debt exceed the authorised limit.

Net Borrowing and Capital Financing Requirements

This indicator requires that the Council's net borrowings should not exceed its Capital Financing Requirement. Actual figures for the year ended 31 March 2017 are compared with the initial estimates approved in January 2016.

	2016-17 Estimate Jan 2016 £m	2016-17 Actual Year End £m
Gross Borrowing*	337.000	324.599
Investments	(185.000)	(263.185)
Net Borrowing	152.000	61.414
Transferred Debt #	(30.032)	(1.145)
CFR	585.650	468.670

#Transferred Debt is debt held by the Council on behalf of Derby City Council, Chesterfield Borough Council & Derbyshire Police.

* PFI and Finance lease liabilities of £78.698m are in addition to the Gross/Net Borrowing figures.

As outlined earlier, the use of internal resources as part of the borrowing strategy reduced both external borrowing and investments.

The above total shows that the Council's net borrowings of £61.4m are significantly less than its capital financing requirement.

Ratio of Financing Costs to Net Revenue Stream

This shows capital financing costs as a proportion of the total revenue stream of 4.7% of total revenue, including Dedicated Schools Grant (DSG) and 8.7% excluding DSG.

Incremental Impact on Council Tax

The impact in the year of new financing costs was within the estimate.

Treasury Management Indicators

The Authority measures and manages its exposures to treasury management risks using the following indicators.

Security: The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment.

	Actual	Minimum
Portfolio average credit rating	AA-	A
Portfolio average credit rating score	4	6

Liquidity: The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling one month period, without additional borrowing.

	Target	Actual
Total cash available within 35 days	£30.000m	£73.699m

Fixed and Variable Rate Exposures

Recommended upper limits on the percentage of borrowing and investments held at fixed and variable rates, as required by the Code, are set out below:

	2016-17 Upper Limit	2016-17 Actual Year End
Borrowing		
Limits on fixed interest rates	100%	90.17%
Limits on variable interest rates*	40%	9.83%
Investments		
Limits on fixed interest rates	25%	24.70%
Limits on variable interest rates	100%	76.30%

- * The Council has £18m of Lenders Option Borrowers Option (LOBO) loans, which are fixed rate loans with an option for the lender to vary the interest rate every 6 months. If the lender exercises this option then the Council has the option to repay the loan in full without penalty.

The Council's borrowing and investments remained within the approved limits.

Maturity Structures

The maturity profile is the rate at which long-term loans have to be repaid to the PWLB (or other lenders). It would be imprudent to have a large proportion of repayments in any one year, thus a spread of redemptions is desirable.

The maturity structure is a prudential indicator under the Code, with lower and upper limits recommended as shown in the table below. These are set quite widely to ensure that full advantage can be taken of interest rate movements and debt rescheduling opportunities, within an acceptable degree of risk.

Borrowing Maturity Structure Term	Limits Lower-Upper %	Amount £m	2016-17 Year End Actual %
Under 12 months	0-15	4.575	1.47
12 months - 2 years	0-15	7.320	2.35
2 years - 5 years	0-40	13.725	4.41
5 years - 10 years	0-40	25.163	8.08
10 years - 20 years	10-40	103.401	33.19
20 years - 30 years	10-40	122.245	39.24
30 years and above	10-40	35.090	11.26
Total		311.519	100.00

The above analysis **excludes** PFI, finance lease liabilities and temporary borrowing.

The Council's debt maturity structure as at 31 March 2017 complied with the limits approved by Full Council.

Longer Term Investments

The prudential code requires councils to set limits for any investments made for more than 364 days. Whilst most of the Council's surpluses are of a temporary nature, others, for example the insurance fund reserve, could reasonably be invested for periods in excess of one year.

A limit for lending for more than one year is set out below and compared with the total amount on deposit at 31 March 2017. The total includes all loans outstanding at 31 March 2017 which, at inception, had over 1 year to maturity.

	2016-17 Limit	2016-17 Actual
Maximum principal sums invested for more than 364 days	£100m	£65m

Longer term investments complied with the limit approved by Full Council.

Former Performance Indicators:

Borrowing:

The Council's performance is measured against the average rate of interest paid by County Councils for the latest financial year. CIPFAs have provided a benchmark of 12 English County Council clients.

Performance Indicator (L/T Borrowing) – 2016-17	%
Derbyshire County Council - (20 Year Average Term)	3.98
English County Councils Average – Cipfa Benchmarking Clients (Average Term – 19.5 Years)	4.06
PWLB 25 Year Rate - (Average 2016-17 rate) - (PWLB)	2.92

The table shows that Derbyshire County Council paid 1.06% above the average 25 year PWLB rate for 2016-17. This is due to borrowing being taken when interest rates were higher than the current low rates.

Derbyshire County Council pays 0.08% below the County Council average of all CIPFA's Treasury Management English County Council clients.

Investments:

The Council's performance is measured against a benchmark market rate of interest (the 3 month LIBID (London Inter-Bank Deposit bid rate). In 2016-17, the average rate received on the Council's investments was 0.86% compared to the benchmark average of 0.32%.