Appendix 1

Annexes A&B to this Appendix are not for publication as they contain exempt information of the description in Paragraphs 14 and 21 of Schedule 12A of the Local Government Act 1972.

Treasury Management Mid-Year Report 2015-16

The City of Cardiff Council

Introduction

1.1 Treasury management activities are the management of an organisation’s investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.

1.2 The Council carries out its treasury management activities in accordance with a code developed for public services in 2011 by the Chartered Institute of Public Finance and Accountancy (CIPFA) as well as Council approved policies and clauses adopted by Council in February 2010.

1.3 In accordance with these policies, this report provides members with a mid year update of Treasury Management activities as at 30 September 2015 and covers:-

- the economic background to treasury activities
- investments
- borrowing
- debt rescheduling
- compliance with treasury limits and prudential indicators
- strategy update for remainder of year.

1.4 Annexe E includes a glossary which defines key terms used in this report. During 2015/16, Audit Committee has received periodic updates on the position and performance of Treasury Management and the issues included in the report below. In addition Council received in September 2015 the Annual Report on the Outturn for Treasury Management for 2014/15.

Economic Background

2.1 Growth forecasts for the UK economy remain positive, however these have recently been tempered by concerns of slower global growth and weakness in stock markets. Inflation measured by Consumer Price Index (CPI) remains low at close to 0%. This is as a result of reduced oil, clothing and energy prices with this supporting increased household spending. However, for any recovery to become more balanced and sustained in the longer term, the view is that there needs to be a move away from dependence on consumer expenditure and the housing market.

2.2 The following table gives the Council’s treasury management advisors, latest forecast of bank rate and Public Works Loan Board (PWLB) borrowing rates: The start of the increases in Bank Rate are assumed to be towards in the second quarter of 2016/17, with any increases at a more gradual rate than previously expected.

	Sep-15	Mar-16	Mar-17	Mar-18
Bank Rate	0.50%	0.50%	1.00%	1.75%
5yr PWLB rate	2.30%	2.50%	3.00%	3.40%
10yr PWLB rate	2.90%	3.20%	3.70%	4.10%
25yr PWLB rate	3.40%	3.80%	4.20%	4.60%
50yr PWLB rate	3.40%	3.80%	4.20%	4.60%

2.3 It can be seen from the table that the cost of borrowing is significantly in excess of the rates that are available from investments. Whilst there have been fluctuations, borrowing rates remain at similar levels to when the Treasury Strategy was approved in February 2015. Whilst geo-political events can have short term impacts on rates, the long term forecast is for PWLB rates to rise due to the high volume of debt issuance in the UK.

2.4 Increased confidence in UK growth, higher inflation expectations and reversal of quantitative easing measures could result in increases in borrowing rates. Conversely re-emergence of problems in heavily indebted European economies, geopolitical risks such as in the Middle East, could result in safe haven flows back to the UK, reducing borrowing rates.

Investment

3.1 The management of the Council's cash flows may involve temporary lending of surplus funds to low risk counterparties or temporary borrowing pending receipt of income.

3.2 The Council's investment priorities are the security and then liquidity of its investments. The Council also aims to achieve the optimum return on its investments appropriate to these priorities.

3.3 The Council invests with financial institutions in accordance with criteria approved in the Treasury Strategy. The categories, names, periods and size limits on this list can be extended, varied or restricted at any time by the Corporate Director Resources under delegated powers. Based primarily on Fitch credit criteria and a number of other factors which the Council takes into account, lending to these institutions is subject to time and size limits and credit worthiness continues to be carefully monitored.

3.4 Given that bank rates are historically low, and the damping effect on interest rates that the Government's Funding for Lending Scheme and minimum capital requirements has had on availability of cash to banks, rates of investment return remain low.

3.5 At the 30 September 2015, investments stood at £53.45 million. These temporary funds fluctuate daily and arise for a number of reasons, including the timing differences between the receipt of grant and other income and the utilisation of these funds on salaries and other operating costs. It includes the level of reserves, provisions, and other balances. It is also affected by the timing of borrowing and capital expenditure transactions. **Annexe A** shows with whom these investments were held as at 30 September 2015. These were all deemed recoverable.

3.6 A selection of performance indicators and benchmarking charts, is included in **Annexe B** as follows:-

- **Counterparty Exposure** displays actual investment against the maximum permitted directly with an organisation. This demonstrates that we are not exceeding any exposure limits.
- **Remaining Maturity Profile of Investments**. This shows the duration of investments is spread and taking advantage of slightly higher rates for longer term investment up to one year where reasonable to do so.
- **Investments by Institution.** This expresses the investments held with different institutions as a percentage of the total and shows diversification is sought where possible.
- **Geographic Spread of Investments** as determined by the country of origin of relevant organisations. All countries are rated AA and above as per our approved criteria, are licensed to take UK deposits. Investments are in Sterling only.
- **Investments by Financial Sector.** The majority of investments continue to be with banks.

3.7 Whilst a difficult figure to forecast due to the uncertainty of the markets, cash flows and the number of variables that impact on the figure, the forecast level of interest receivable from treasury investments for 2015/16 is £300,000 as included in our current projections for capital financing in the Month 6 Budget Monitoring Report. The return achieved since the start of the year is 0.70% compared to the benchmark 7 day London Interbank Bid Rate (LIBID) 0.36%.

3.8 The Council currently uses the Debt Management and Deposit Facility (DMADF) as a last resort if no alternative investment opportunities are available. The maximum rates available from the facility are 0.25%.

Borrowing

4.1 Long term borrowing is undertaken to finance the Council's Capital Programme and the main sources of borrowing currently are the PWLB and the Money Markets. The Council does not separate General Fund and Housing Revenue Account borrowing as all borrowing is the liability of the Council.

4.2 At 30 September 2015, the Council had £655.9 million of external borrowing predominantly made up of fixed interest rate borrowing from the PWLB payable on maturity.

31-Mar-15			30-Sept-15	
£m	**Rate (%)**		**£m**	**Rate (%)**
418.1		Debt from : PWLB	603.5	
52.0		Market	52.0	
0.4		Other	0.4	
470.5	**5.19**	**Total External Debt**	**655.9**	**4.90**

New borrowing undertaken

4.3 In accordance with previous reports to Council, a settlement payment to WG was made on 2 April 2015 of £187 million to exit the Housing Finance Subsidy System. This payment was made by undertaking external borrowing. In accordance with the requirements of the agreement with WG and HM Treasury, the level of borrowing had to generate a required level of interest payable in the first five years, be taken only from the PWLB and be at special rates of interest determined by the PWLB and HM Treasury.

4.4 Details of the background to the settlement and financial implications of the settlement are shown in Annexe D, with the strategy adopted in determining the loans and periods being a balance of:-

- meeting the requirements of the settlement agreement
- minimising the length of loans
- consideration of existing Council debt to ensure a spread of loan maturities and maintaining a single pool for Council Fund and HRA debt.

4.5 The estimated net HRA revenue benefit p.a after capital financing costs is £3.3 million, with any such benefit to be re-invested in existing and new housing stock in accordance with the HRA Business Plan.

Maturing Loans in Year

4.6 Annexe C shows the maturity profile of the Council's borrowing as at 30 September 2015. The main loans maturities during 2015/16 are PWLB loans of £2 million repaid in the first half of this year, with a further £3.6 million of PWLB loans to be repaid by the end of the financial year.

Unless the Council's Lender Option Borrower Option loans (LOBO's) are required to be repaid early, very little debt matures within the next 10 years.

4.7 (LOBO) products are loans to the Council where the lender can request a change in the rate of interest payable by the Council on pre-determined dates. The Council at this point has the option to repay the loan.

4.8 The Council has 6 such loan totalling £51 million. And apart from the option to increase rates these loans are comparable to PWLB and have no other complications such as variation in interest rates or complex terms.

4.9 Interest rates on the Council's loans range between 3.81% and 4.35% which are not unreasonable and are below the Council's average rate of interest payable. Details of the loans are shown in the table below.

£m	**Potential Repayment Date**	**Option Frequency**	**Full Term Maturity**
6	01/03/2016	6 months	23/05/2067
6	21/11/2015	6 months	21/11/2041
6	21/11/2015	6 months	21/11/2041
6	21/11/2015	6 months	23/05/2067
22	21/11/2015	5 years	23/11/2065
5	05/01/2018	5 years	17/01/2078

4.10 LOBO's to the value of £24 million are subject to the lender potentially requesting a change in the rate of interest payable every six months, which could trigger early repayment. This is deemed unlikely and any risk is a manageable refinancing risk as LOBO's form a relatively low proportion of the Council's overall borrowing at 7.8%.

Borrowing Strategy

4.11 If no further borrowing is undertaken, the value of external loans at 31 March 2016 will be £652.3 million. At the same point, the Council's need to borrow for capital expenditure purposes, its Capital Financing Requirement (CFR) is currently forecast to be circa £714 million (General Fund £436 million and HRA £278 million). As the Council undertakes capital expenditure commitments, its CFR rises and as it sets aside money for the eventual repayment of such expenditure (Minimum Revenue Provision), the CFR falls. The level of CFR is dependant on a range of factors including progress in implementing the Capital Programme during the year so this estimate can change. Without any further borrowing this financial year internal borrowing could be £62 million.

4.12 The borrowing strategy outlined in the February 2015 budget report indicated that:-

Whilst investment rates remain lower than long term borrowing rates internal borrowing will be used to minimise short-term costs where possible. The forecast level of internal borrowing as a percentage of the CFR is deemed manageable. However, based on the current forecasts of future capital expenditure plans and high level analysis of the sustainability of internal borrowing from the Council's balance sheet position for future years, external borrowing will be required to be undertaken in the medium term.

4.13 Long term borrowing rates are significantly higher than investment rates which mean that the cost of undertaking any new borrowing would have a negative impact on the revenue budget, accordingly no new borrowing has been undertaken to date. External borrowing may be deferred in order to minimise short term costs by using temporary cash balances to pay for capital expenditure however deferring borrowing is only a short term measure and could expose the Council to higher borrowing rates and costs in the future.

4.14 Accordingly, it is proposed to take an element of the Council's borrowing requirement (up to £15 million) during the remainder of this financial year with timing of such determined by the Corporate Director Resources in conjunction with the Council's treasury advisors. This has been factored into the Month 6 revenue budget monitoring position, which shows a projected underspend on external interest costs due to deferring the timing of borrowing. The estimate of interest payable on borrowing for 2015/16 is £32 million.

Debt Rescheduling

5.1 No debt rescheduling or early repayment of debt has been undertaken during the year to date. The main obstacle is the level of premium (penalty) chargeable on early repayment by the PWLB.

5.2 Whilst the cost of Premiums can be spread over future years, options for restructuring that have been considered result in an adverse Net Present Value (NPV). Whilst there may have been short terms savings, these were outweighed by potentially longer term costs. In addition and more significantly, the capital programme and investment requirements set by the Council, has a need to undertake additional external borrowing in future years. This is potentially when interest rates are higher, based on current forecasts. Were this not the case and the Council were to have surplus cash balances for a long period of time, then paying such premiums would be cost effective.

Compliance with treasury limits and prudential indicators

5.3 During the financial year to date, the Council has operated within the treasury limits and prudential indicators set out in the annual Treasury Management Strategy in February 2015.

5.4 Following Housing Finance Reform the Council complies with an indebtedness cap in the Housing Revenue Account of £316.5 million. This will need to be monitored closely as part of the Treasury Strategy and HRA Business Planning process.

Strategy update for the remainder of 2015/16

6.1 As identified in the report above, a key issue for the remainder of this year is the timing of additional borrowing in order to not be exposed to a significant level of internal borrowing at the end of the year. Up to £15m will be borrowed in the second half of the year with the potential benefit of reduced rates available as part of the Council's investment in 21st Century Schools.

6.2 A further update on Treasury Management will be included in an update to the Treasury Management Strategy for 2016/017 as part of the Budget Proposals in February 2016.

Annexes

Annexe A – Investments at 30 September 2015
Annexe B – Investment Charts at 30 September 2015
Annexe C – Maturity Analysis of Borrowing as at 30 September 2015
Annexe D – Housing Revenue Account Subsidy (HRAS) System Exit
Annexe E – Glossary of Treasury Management terms