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Annexes A&B to this Appendix are not for publication as they contain exempt information of the description in Paragraphs 14 and 21 of Schedule 12A of the Local Government Act 1972.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 2016-17

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 2016 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 D includes a glossary which defines key terms used in this report. During 2016/17, 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 2016 the Annual Report on the Outturn for Treasury Management for 2015/16.

Economic Background

2.1 The referendum vote for Brexit in June resulted in an initial shock fall in economic indicators. Though it is generally accepted that the economy will now avoid flat lining, weak growth in the EU, China and emerging markets is also likely to result in weak UK growth. In response, the Bank of England reduced bank rate from 0.50% to 0.25% in August 2016. Exchange rate volatility is expected to increase inflation in the short term with a forecast of 2.4% in 2018.

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 view is that there could be further reductions in the short term, without any increases until June 2018. However, this position will be kept under review as potential inflationary pressures increase.

	Sep-16	Mar-17	Mar-18	Mar-19
Bank Rate	0.25%	0.10%	0.10%	0.25%
5yr PWLB rate	1.01%	1.00%	1.10%	1.20%
10yr PWLB rate	1.52%	1.50%	1.60%	1.70%
25yr PWLB rate	2.27%	2.30%	2.40%	2.50%
50yr PWLB rate	2.10%	2.10%	2.20%	2.30%

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. PWLB borrowing rates are based on Gilt yields which have seen a significant reduction due to economic uncertainty and a bond buying programme increasing demand for safe have assets. Whilst geo-political events can have short term impacts on rates, the overall long term forecast is for PWLB rates to rise slowly.

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 remain 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 rates of investment return also remain low.

3.5 At the 30 September 2016, investments stood at £88.9 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 2016. These are 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 and 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 2016/17 is £490,000 as included in our current projections for capital financing in the Month 6 Budget Monitoring Report for the Council. The return achieved since the start of the year is 0.68% compared to the benchmark 7 day London Interbank Bid Rate (LIBID) of 0.28% and 3 month LIBID 0.38%.

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 0.15%.

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 Where capital expenditure has been incurred without a resource to pay for it immediately e.g. via capital receipts, grants or other contributions, this will increase what is termed the Council's Capital Financing Requirement (CFR) or its need to undertake borrowing. The Council is required to make an annual prudent provision for the repayment of historic capital expenditure from its revenue budget. This reduces the CFR. Calculation of the CFR is summarised in the following table.

	Opening Capital Financing Requirement (CFR)
+	Capital expenditure incurred in year
-	Grants, contributions, reserves and receipts received to pay for capital expenditure
-	Prudent Minimum Revenue Provision & Voluntary Repayment
=	Closing Capital Financing Requirement (CFR)

4.3 The level of CFR is dependant on a range of factors including progress in implementing the Capital Programme during the year so estimates can change.

4.4 At 30 September 2016, the Council had £674.1 million of external borrowing predominantly made up of fixed interest rate borrowing from the PWLB payable on maturity.

31-Mar-16			30-Sep-16	
£m	**Rate (%)**		**£m**	**Rate (%)**
612.8		Public Works Loan Board (PWLB)	620.8	
52.0		Market	52.0	
0.5		Welsh Government	0.5	
0.8		Other	0.8	
666.1	**4.84**	**Total External Debt**	**674.1**	**4.81**

New borrowing undertaken during the year to date

4.5 Two new loans have been undertaken from the PWLB totalling £10 Million at an average rate of 2.53% and an average maturity of forty three years.

Maturing Loans in year to date

4.6 Annexe C shows the maturity profile of the Council's borrowing as at 30 September 2016. PWLB loans of £2 million have been repaid in the first half of this year, with a further £3.6 million of PWLB loans and £1 million of Market loans due to be repaid by 31 March 2017. 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 loans 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	21/11/2016	6 months	21/11/2041
6	21/11/2016	6 months	21/11/2041
6	21/11/2016	6 months	23/05/2067
6	01/03/2017	6 months	23/05/2067
5	15/01/2018	5 years	17/01/2078
22	21/11/2020	5 years	23/11/2065

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 7.6%.

Borrowing Strategy

4.11 The borrowing strategy outlined in the February 2016 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 at 31 March 2016 in relation to 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.

4.12 As is shown in above, long term borrowing rates are significantly higher than investment rates which mean that the cost of undertaking new borrowing would have a negative impact on the revenue budget. External borrowing may be deferred in order to minimise short term costs by using temporary cash balances to pay for capital expenditure rather than placing in an investment. This is termed 'internal borrowing'. However deferring borrowing is only a short term measure and could expose the Council to higher borrowing rates and costs in the future. The Council has taken an approach of undertaking external borrowing for an element of any borrowing requirement to mitigate any such risk.

4.13 If no further borrowing is undertaken, the value of external loans at 31 March 2017 will be £669.5 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 £724 million (General Fund £446 million and HRA £278 million). Without any further borrowing this financial year internal borrowing could be £55 million, which is deemed manageable.

4.14 It is currently assumed that no further external borrowing will take place during the remainder of this financial year. This has been factored into the Month 6 revenue budget monitoring position with the estimated total interest payable on borrowing for 2016/17 being £32.4 million.

Debt Rescheduling

5.1 No debt rescheduling or early repayment of debt has been undertaken to date. The main obstacle remains the level of premium (penalty) that would be chargeable on early repayment by the PWLB. The premium payable on the balance of PWLB loans at 30 September 2016 which are eligible for early repayment (£403 million) is £348 million. This premium is payable primarily because:-

- Interest rates on loans of equivalent maturities compared to those held are currently lower
- A penalty rate or lower early repayment rate was introduced by HM Treasury in November 2007, which increased the cost of premiums and reduced flexibility of Local Authorities to make savings. This remains an obstacle in the ability of local authorities to manage debt more effectively.

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 and not deemed cost effective.

5.3 Opportunities for restructuring will continue to be considered in conjunction with our Treasury advisors and reported to Audit Committee periodically as part of standard Treasury Management updates which Cabinet and Council receive.

Compliance with treasury limits and prudential indicators

6.1 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 2016.

6.2 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 2016/17

7.1 During the remainder of the year, the reduction in Bank of England base rate to 0.25% in August 2016 and impact on interest rates for both investments and borrowing will continue to be reviewed. A strategy of maintaining internal borrowing to maximise short term savings will continue for the next 6 months.

7.2 A further update on Treasury Management will be included in the Treasury Management Strategy for 2017/18 as part of the Budget Proposals in February 2017.

Annexes

Annexe A – Investments at 30 September 2016
Annexe B – Investment Charts at 30 September 2016
Annexe C – Maturity Analysis of Borrowing as at 30 September 2016
Annexe D – Glossary of Treasury Management terms