Leicester
City Council

WARDS AFFECTED:
ALL WARDS (CORPORATE ISSUE)

OVERVIEW SELECT COMMITTEE **22nd June, 2016**

REVIEW OF TREASURY MANAGEMENT ACTIVITIES 2015/16

Report of the Director of Finance

1. **Purpose of Report**

1.1 This report reviews how the Council conducted its borrowing and investments during 2015/16.

1.2 For over 10 years the Council has not needed to borrow any money, whilst its investments have grown – this is a result of Government policy in respect of funding capital expenditure. Thus, the prime focus of treasury management is the security and performance of investments (with priority given to security).

1.3 2015/16 has seen economic growth pick up in the UK and elsewhere. However this growth was variable across the world, and where it was strong (USA and China) there are risks in 2016/17.

1.4 The concerns that the rate of world economic growth will disappoint have led to an expectation that interest rates will be be "lower for longer".

1.5 This report is written in the run up to the referendum on continued UK membership of the EU and this is discussed later in the report.

1.6 We continue to monitor the impact of the "bail in" rules, which require major depositors (such as us) to inject funds into banks which are running into trouble. These rules were introduced earlier in the year. This is further discussed below.

2. **Summary**

2.1 Treasury Management is the process that ensures that the Council always has enough cash to make the payments that are necessary for its operations, and this involves both borrowing and investment. The Council's borrowing totals some £240 million; and during 2015/16 its investments varied from below £147 million to over £246 million depending on circumstances.

2.2 The Council has a prudent approach to treasury management. It does not borrow more than it needs; generally preferring to use cash balances as an alternative to borrowing. In recent years we have not needed to borrow at all. It only lends to banks which are very strong and this discipline is enforced by maintaining a regularly updated list of who we will lend to. A particularly cautious approach has been adopted during the period of global economic difficulty since 2008.

2.3 The report commences with an overview of treasury management, including loans and investments at key dates. It then reviews the credit worthiness of investments and implementation of our strategy, provides outcomes on key performance measures and concludes by reviewing compliance against limits set by the Council.

3. Recommendations

3.1 Members of the Overview Select Committee are recommended to note the report and make any comments to the Director of Finance and the Executive as they wish.

4. Overview of Treasury Management

Main elements of Treasury Management

4.1 There are two main elements to treasury management. The first is managing our borrowings which have been taken out to finance capital expenditure. Most capital schemes are now financed by grant, and only a limited number of schemes of local significance are financed by borrowing. In the past the Government expected us to borrow but allowed for the cost of borrowing in our grant settlement, and we still have a lot of debt which was taken to meet this capital expenditure.

4.2 Historic debt can sometimes be restructured to save money (i.e. repaying one loan and replacing it with another) and this is always given active consideration. In recent years, Government rule changes have normally made this prohibitively expensive.

4.3 The revenue budget approved by the Council for each financial year includes provision for the interest payable on this borrowing. It also includes a provision for repaying the borrowing over a number of years (broadly speaking over the economic life of the assets acquired).

4.4 The second element is cash management which involves managing the Council's investments to ensure the optimum amount of money is in the bank account on a day-to-day basis – so that there is enough money on the account to cover the payments made on the day but no more (cash held on the bank account earns neglible interest).

4.5 The Council has substantial investments but this is not "spare cash". Some comes from grants received in advance of expenditure and from reserves held for designated purposes. It also includes money set aside to repay debt but which has not been used to repay debt due to the punitive charges referred to above.

4.6 There is a provision for interest earned on investments in the Council's revenue budget.

Treasury Management Policy and Monitoring

4.7 The activities to which this report relates were governed by the Treasury Strategy for 2015/16 which was approved by the Council on 22nd January 2015. This established an outline plan for borrowing and investment. The strategy was drawn up in the light of the Council's expected borrowing requirements, its expected cash balances, the outlook for interest rates and the credit worthiness of the banks with whom the Council might invest its cash balances.

4.8 A twice-yearly report is submitted to your Committee reviewing the treasury activity undertaken in the year. This report is the year-end report for 2015/16.

Loans and Investments at Key Dates

4.9 Table 1 below shows the loans (money borrowed by the Council) and investments (money invested by the Council) at 19/11/2015 and 31/03/2016. The rates shown are the averages paid and received during 2015/16.

4.10 It can be seen that the level of gross debt (total loans borrowed) is unchanged at a level of £239m. No new loans have been borrowed and no debt restructuring has taken place.

4.11 Investments have decreased by £62m from £211m to £149m. This movement is broadly in line with expectations – cash balances at year-end are often low and subsequently increase at the start of the new financial year.

Table 1- Loans & Investments

	Position at 19/11/2015 Principal £M	**Position at 31/03/2016 Principal £M**	**Average Rate 2015/16**
Long Term Fixed Rate Loans			
Public Works Loan Board (PWLB)	134	134	4.2%
Market & Stock	9	9	7.0%
Variable Rate Loans			
Bank Loans	96	96	4.4%
Gross Debt	239	239	4.4%
Investments			
Banks and Build Soc	78	84	
Other Local Authorities	108	59	
Government Treasury Bills	5	0	
Money Market Funds	20	6	
Total Investments	211	149	0.6%
NET BORROWING	**28**	**90**	

5. **Credit Worthiness of Investments**

5.1 2015/16 showed increasing signs of economic recovery within the UK economy and within the world economy (albeit more sluggish than anticipated at the start of 2015/16). Within the euro zone the overall picture was one of economic recovery with the impact varying from country to country and with this recovery taking place against a background of continuing risks within the euro zone.

5.2 The governments of the largest world economies, including the UK, have implemented measures to make banks less likely to fail but also to reduce the impact on the financial system and on tax payers if they do fail. The measures for dealing with a failing bank see investors who have lent or deposited money taking significant losses before there is any tax payer support ("bail in"). Our assessment of risk is based both on the risk that banks fail (as measured by credit ratings) and also on the level of losses that we might face should the banks fail (or more likely require capital support to prevent failure).

5.3 These developments were reflected in the Council's approach to managing credit risk in its Treasury Strategy for 2015/16. It has adopted a cautious stance over the whole period covered by this report, but has also sought to diversify to reflect the fact that our money can now never be safely invested for long periods in a single bank. We have improved returns by lending for longer periods to other local authorities and using investments in banks which are secured on banks' assets.

5.4 The position remains under review. One factor is that other regulatory developments are continuing to require or push banks towards greater financial robustness in terms of their liquidity (their ability to sustain large outflows of cash) and capital strength (their ability to absorb losses).

5.5 Further matters under review are the measures that will be put in place to require banks to "ring fence" bank deposits from other more risky activities. These changes will not come into effect until January 2019. It is expected that the Council will have adequate time to assess the impact of "ring fencing" on the credit worthiness of its investments and to respond appropriately and will be supported by our treasury advisors.

5.6 The Council has an indirect exposure to non-UK banks through its investment in money market funds. At the time of preparing this report one fund is invested in, but we are looking to open a further 2-3 funds. Money market funds are like "unit trusts" but rather than investing in company shares these funds invest in interest bearing investments such as bank deposits. When we open such funds they are vetted to ensure that there is a high level of credit worthiness in the underlying investments, and we receive advice from our treasury advisor, Arlingclose. Investing in this way helps manage credit risk by having a high level of diversification amongst the underlying banks and institutions to whom money is lent.

5.7 The Treasury Strategy for 2016/17 permitted investments in the CCLA property fund. However, a number of large property funds have recently performed poorly, something which some commentators attribute in part to fears that the UK will leave the EU (slower world economic growth is cited as a factor too). Given this uncertainty any such investment decisions will be deferred until after the referendum.

6. **Implementation of Borrowing & Investment Strategy**

6.1 The strategy approved by Council for 2015/16 envisaged using cash balances instead of borrowing, and this strategy has been adhered to.

6.2 Given that the Council continues to have a high level of investments, active consideration is given to the possible early redemption of a limited amount of debt. This, however, is not straightforward as debt repayment usually involves the payment of a premium. The level of such premiums payable in 2015/16 was too high for premature debt redemption to be viable.

7. **Key Performance Measures**

7.1 The most important performance measures are the rate of interest on the Council's borrowings, the timing of borrowing decisions, the timing of decisions to prematurely repay debt and the return on investments. The second and the third of these do not apply in 2015/16 because no new loans have been borrowed and no existing loans have been prematurely repaid.

7.2 The Council is a member of a benchmarking club: the latest data is for the second quarter of 2015/16 (full year data will be available for the next review of treasury activities). The average rate of interest on investments for members of that club is 0.82%. The Council's own rate is lower: 0.50%. This difference in performance can be attributed in part to the average authority investing for longer periods.

7.3 As at 30th September 2015 the average maturity of our investments was 112 days whereas the group average was 177 days. When data is available for 2015/16 we would expect that our average maturity is close to the group average as the implementation of our 2015/16 strategy has increased the average maturity of our investments. As at 30th September 2014 the average maturity of our investments was 81 days and the figure as at 30th September 2015 stood at 112 days and at 31st March 131 days.

7.4 The average rate of interest on all investments held at 1st April 2015 was 0.48% and 0.73% at 31st March 2016. The increase of 0.25% is mainly attributable to the increase in the average maturity of our investments. At the time of drafting this report benchmarking data for 2015/16 is not available (but will be available for the next report). It it likely that when this data is available that it show that the return on our investments is lower than that of the average authority with this difference being attributable to our cautious approach to credit risk. In particular a lot of our investments are, and will remain with, other local authorities.

7.5 There is a relationship between the credit rating of an investment and its return – generally the higher the credit rating the lower the return and visa-versa. As well as receiving information from the benchmarking club we also receive benchmarking data from our Treasury Advisors. We have reviewed this data and discussed it with our advisors who advise that we have struck an appropriate balance between risk and reward. They also support the approach of seeking higher returns by continuing to increase the average maturity of some of our investments.

7.6 The current low interest rate environment is forecast to continue for a number of years (although interest rates are expected to rise slowly) and this consideration will feed into the review as to whether cash balances should be used repay existing long-term, fixed rate, debts.

8. Use of Treasury Advisors

8.1 The Council are advised by Arlingclose Ltd. They advise on all aspects of treasury management but their main focus is on providing advice on the following matters:

- the creditworthiness of banks
- the most cost effective ways of borrowing
- appropriate responses to Government initiatives
- technical and accounting matters.

8.2 The service is being routinely retendered.

9. Compliance with the Council's Treasury Strategy

9.1 As required by the statutory borrowing framework, the Council is required to set a number of prudential limits and indicators, and is encouraged to supplement these with local indicators when appropriate. These limits are set annually and can be found within the budget and Treasury Strategy.

9.2 For the operational implementation of the Council's Treasury Management Strategy, the most important limits and indicators that need to be monitored throughout the year are:

- The authorised limit – the maximum amount of borrowing that the Council permits itself to have outstanding at any one time
- The operational limit – a lower limit to trigger management action if borrowing is higher than expected.
- The maximum proportion of debt that is fixed rate.
- The maximum proportion of debt that is variable rate.
- Limits on the proportion of debt maturing in a number of specified time bands
- Limits on sums to be invested for more than 364 days

9.3 These limits are monitored, and have been complied with.

10. Financial and Legal Implications

10.1 This report is solely concerned with financial issues. Kamal Adatia, Legal Services has been consulted as Legal Advisor and there are no legal issues.

11. Other Issues

OTHER IMPLICATIONS	YES/NO	Paragraph References Within Supporting information
Equal Opportunities	No	
Policy	No	
Sustainable and Environmental	No	
Crime and Disorder	No	
Human Rights Act	No	
Elderly/People on Low Income	No	

Corporate Parenting	No	
Health Inequalities Impact	No	

12. **Background Papers**

12.1 The Council's Treasury Management Strategy - "Treasury Strategy 2015/16" – Council 21st January 2016. The Council's Treasury Policy Document – "Framework for Treasury Decisions" – Council 29 March 2012.

13. **Consultation**

13.1 Arlingclose Ltd (the Council's Treasury Management advisers).

14. **Author**

14.1 The author of this report is David Janes, Treasury Manager, on extension 37 4058.

Alison Greenhill
Director of Finance.