Report

Audit Committee

Part 1

Date: 8 December 2015

Item No:

Subject	**Report on Treasury Management for the period to 30 September 2015**
Purpose	To inform the Council of treasury activities undertaken during the period to 30 September 2015.
Author	Assistant Head of Finance
Ward	General

Summary

The Council continues to be both a s/t investor of cash and borrower to manage day-to-day cash-flow's . Current forecasts indicate that in the future, temporary borrowing will continue to be required to fund normal day to day cash flow activities and to fund borrowing for the City Centre Redevelopment. A restructure of a number of PWLB loans took place in April 2015, which allowed for significant interest rate savings as a result of re-borrowing at substantially lower interest rates. Apart from the re-structure of this debt and the funding for the City Centre Redevelopment, no additional long term borrowing has been undertaken to date.

With the City Centre Redevelopment approaching its conclusion, discussions about the sale of the development will begin. The timing of the sale will have significant impact on the cash flow activities of the authority, with the potential of large sums of cash being received prior to the offsetting borrowing of the Council itself, maturing. Details of how this will be invested in the short-medium term will be included in the Treasury Management Strategy in January.

There are no proposed changes to the Counterparty limits for UK Banking. However, the maximum lending period for a number of the UK Institutions have been revised as advised by the Authority's Treasury Management Consultants (Arlingclose Ltd), see Appendix D.

Proposal	**To note the report on treasury management activities for the period to 30 September 2015.**
Action by	Head of Finance
Timetable	Immediate

This report was prepared after consultation with:

- Treasury Advisors
- Head of Finance

Please list here those officers and members you have consulted on this report.

Signed

Background

1. The Council's Treasury Management Strategy and Prudential Indicators were approved by Council in February 2015 alongside the Medium Term Financial Plan and the 2015/16 Budget.

2. The Treasury Management Strategy for 2015/16 has been underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2011, which includes the requirement for determining a treasury strategy on the likely financing and investment activity for the forthcoming financial year. The Code also recommends that members are informed of Treasury Management activities at least twice a year. This report therefore ensures this authority is embracing best practice in accordance with CIPFA's recommendations.

3. Treasury management is defined as: "The management of the local authority'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."

4. The report has been prepared in accordance with the CIPFA Treasury Management Code and the Prudential Code, and reviews and reports on:

- Borrowing Activity and Rescheduling
- Investment Strategy and proposed changes to the Council's approved investment limits
- Economic Background
- Compliance with Prudential Indicators approved by Council

Short and Long Term Borrowing

5. Whilst the Council has significant long term borrowing requirements, the Council's strategy of funding capital expenditure through reducing investments rather than undertaking new borrowing remains i.e. we defer taking out new l/t borrowing and fund capital expenditure from day to day positive cash-flows for as long as we can. By using this strategy the Council can minimise cash holding at a time when counterparty risk remains high. The interest rates achievable on the Council's investments are also significantly lower than the current rates payable on long term borrowing.

6. Whilst the strategy minimises investment counterparty risk, the risk of interest rate exposure is increased as the current low longer term borrowing rates may rise in the future. The market position is being constantly monitored in order to minimise this risk.

7. In April 2015 the Council undertook a re-scheduling of a number of debts relating to PWLB. A total of £16.3m debt with an average interest rate of 9.4% was re-paid early. As is normal in these circumstances in the current lower interest environment, a premium was payable on redemption, and new long-term loans at a much improved average interest rate of 2.19% was taken out. This allowed the authority to make significant annual savings on the interest payable on these loans, even with the premium, and was part of the approved 2015/16 budget savings.

8. As anticipated, during the year, the authority has undertaken additional long-term borrowing of £25.0million to the end of September, associated with city centre redevelopment funding of the approved loan to Queensberry Real Estates (Newport) Ltd (QRE). The borrowing associated with this loan is kept separate from the Council's other borrowing requirements shown in Appendix C. The loan is anticipated to be paid off via capital receipts in 2016/17, therefore the Council is not required to make MRP charges to the revenue budget in relation to the Friars Walk Development loan as the borrowing will be paid off in full at the end of the scheme.

9. Further borrowing will be required in the coming months in the finalisation of the Friars Walk Development, and once receipt of payment is in; the Council will need to review its Treasury Management Strategy to ensure prudent investment of any surplus cash in the short to medium term.

10. With the exception of the re-scheduling of debts and the Queensberry loans discussed above, no further long term loans have been taken out in the first half of the financial year. However, it is anticipated that the Council will need to undertake additional borrowing on a short term basis for the remainder of the year in order to cover normal day to day cash flow activity. With current estimates it is not expected that any additional long-term borrowing would be required at this stage.

11. Appendix C summarises the Council's debt position as at 30 September 2015. The changes in debt outstanding relate to the raising and repaying of the rescheduling of debt, temporary loans, and a repayment in respect of the soft loans.

12. The value of the Council's LOBO money market loans remains the same. No loans were called during the period. Of the £35m outstanding, £25m is subject to potential change of interest rates by the lender (which would automatically trigger a right to the Council to repay these loans) prior to the end of this financial year. Should a change of interest rate be requested, then it will be considered in detail and a decision on how we proceed will be made in conjunction with our treasury advisors.

Investments

13. As per the agreed strategy, the Council will be a short-term investor to maintain low cash balances as required. As at 30th September 2015, there was £3.715m balance on short-term investments outstanding. Across a typical month, the Council both invests and borrows short term to manage day-to-day cash-flow's.

14. Following the completion of the City Centre re-development the Council may have surplus cash to invest in relation to payment received from the sale of the development. This is because the repayment could be received prior to the loans the Council took out itself in relation to this, maturing themselves.. Investment of this surplus cash will need to be allocated where it minimises risk while achieving a return for the Council, prior to using the cash to repay the Council's own l/t borrowing in relation to this scheme.

15. The Council does not hold any long-term (more than 364 days) investments as at 30th September 2015.

16. There were no significant changes in credit ratings advised in the first half of the financial year that had implications for the approved lending list. The long term rating of Santander UK, the Council's bankers, remains at A just above the Council's minimum level of A-.

Economic Background

17. Appendix A outlines the underlying economic environment during the first half of the financial year, as provided by the Council's Treasury Management Advisors Arlingclose.

Compliance with Prudential Indicators approved by Council

18. The Authority can confirm that it has complied with the Prudential Indicators for 2015/16 set in February 2015 as part of the Treasury Management Strategy. Details of treasury-related Prudential Indicators can be found in Appendix B.

19. During the period the Council's treasury advisors have advised that the maximum lending period for the Counterparty Institutions are now 13 months. This Lending Period changes relate to Lloyds Banking Group and HSBC Bank Ltd. Details of the current counterparty limits and lending periods of UK institutions can be found in Appendix D.

Financial Summary

- There are no direct costs arising from this report.

Risks

Risk	Impact of Risk if it occurs* (H/M/L)	Probability of risk occurring (H/M/L)	What is the Council doing or what has it done to avoid the risk or reduce its effect	Who is responsible for dealing with the risk?
Investment counterparty not repaying investments	High but depending on investment value	Low	The Council only invests with Institutions with very high credit scores. It employs advisors to monitor money market movements and changes to credit scores and acts immediately should things change adversely. The lower levels of funds available for investment will also alleviate the risk.	Members, Head of Finance, Treasury staff, based on advice from treasury advisors
Interest Rates moving adversely against expectations	Low	Low	Base and short-term Interest rates are expected to remain at current levels until Q3 in 2016. The Treasury strategy approved allows for the use of short term borrowing once investment funds are exhausted to take advantage of these low rates.	Head of Finance, Treasury staff, treasury advisors

* Taking account of proposed mitigation measures

Links to Council Policies and Priorities

It is the Council's policy to ensure that the security of the capital sums invested is fully recognised and has absolute priority. The Council follows the advice of the Welsh Governments that any investment decisions take account of security, liquidity and yield in that order.

Options Available

The Prudential Code and statute requires that, during and at the end of each financial year, reports on these matters are presented to Council for approval. Thus the only option available is consider the report.

- To approve changes to counterparty investment changes to the maximum period detailed in the report.

Preferred Option and Why

Note the contents of the report and approve the changes to the maximum lending period relating to counterparty investment limits.

Comments of Chief Financial Officer

There are no direct financial implications from this report. Decisions made on treasury matters will be made with a view the Treasury Management Strategy, Treasury Advisors and Prudential Indicators.

Comments of Monitoring Officer

There are no legal implications. The in year and annual treasury management report is consistent with relevant Chartered Institute of Public Finance and Accountancy Guidance, Treasury Management principles and the Council's investment strategy.

Staffing Implications: Comments of Head of People and Business Change

There are no staffing implications arising from this report.

Comments of Cabinet Member

N/A.

Background Papers

Treasury Management Strategy report to Audit Committee January 2015.
Report to Council February 2015: 2015/16 Budget and Medium Term Financial Plan

Dated: 11 November 2015

APPENDIX A

External Context

As the year began, economic data was largely overshadowed by events in Greece. Markets' attention centered on the never-ending Greek issue stumbled from turmoil to crisis, running the serious risk of a disorderly exit from the Euro. The country's politicians and the representatives of the 'Troika' of its creditors - the European Commission (EC), the European Central Bank (ECB) and the International Monetary Fund (IMF) – barely saw eye to eye. Greece failed to make a scheduled repayment to the IMF on 30th June, in itself not a default until the IMF's Managing Director declares it so. Prime Minister Tsipras blindsided Greece's creditors by calling a referendum on 5th July on reform proposals which by then were off the table anyway. The European Central Bank froze liquidity assistance provided to Greek banks and capital controls within the country severely restricted individuals' and corporates' access to cash.

On 12th July, following a weekend European Union Summit, it was announced that the terms for a third bailout of Greece had been reached. The deal amounting to €86 billion was agreed under the terms that Greece would see tax increases, pension reforms and privatisations; the very reforms Tsipras had vowed to resist. This U-turn saw a revolt within the ruling Syriza party and on 27th August, Alexis Tsipras resigned from his post as Prime Minster of Greece after just eight months in office by calling a snap election, held on 20th September. This gamble paid off as Tsipras led his party to victory once again, although a coalition with the Independent Greeks was needed for a slim parliamentary majority. That government must now continue with the unenviable task of guiding Greece through the continuing economic crisis – the Greek saga is far from over.

The summer also saw attention shift towards China as the Shanghai composite index (representing China's main stock market), which had risen a staggering 50%+ since the beginning of 2015, dropped by 43% in less than three months with a reported $3.2 trillion loss to investors, on the back of concerns over growth and after regulators clamped down on margin lending activity in an effort to stop investors borrowing to invest and feeding the stock market bubble. Chinese authorities intensified their intervention in the markets by halting trading in many stocks in an attempt to maintain market confidence. They surprised global markets in August as the People's Bank of China changed the way the yuan is fixed each day against the US dollar and allowed an aggressive devaluation of the currency. This sent jitters through Asian, European and US markets impacting currencies, equities, commodities, oil and metals. On 24th August, Chinese stocks suffered their steepest one-day fall on record, driving down other equity markets around the world and soon becoming known as another 'Black Monday'. Chinese stocks have recovered marginally since and are trading around the same level as the start of the year. Concerns remain about slowing growth and potential deflationary effects.

UK Economy: The economy has remained resilient over the last six months. Although economic growth slowed in Q1 2015 to 0.4%, year/year growth to March 2015 was a relatively healthy 2.7%. Q2 2015 GDP growth bounced back and was confirmed at 0.7%, with year/year growth showing slight signs of slowing, decreasing to 2.4%. GDP has now increased for ten consecutive quarters, breaking a pattern of slow and erratic growth from 2009. The annual rate for consumer price inflation (CPI) briefly turned negative in April, falling to -0.1%, before fluctuating between 0.0% and 0.1% over the next few months. In the August Quarterly Inflation Report, the Bank of England projected that GDP growth will continue around its average rate since 2013. The Bank of England's projections for inflation remained largely unchanged from the May report with them expecting inflation to gradually increase to around 2% over the next 18 months and then remain there in the near future. Further improvement in the labour market saw the ILO unemployment rate for the three months to July fall to 5.5%. In the September report, average earnings excluding bonuses for the three months to July rose 2.9% year/year.

The outcome of the UK general election, largely fought over the parties' approach to dealing with the consequences of the structural deficit and the pace of its removal, saw some very big shifts in the political landscape and put the key issue of the UK's relationship with the EU at the heart of future politics.

The US economy slowed to 0.6% in Q1 2015 due to bad weather, spending cuts by energy firms and the effects of a strong dollar. However, Q2 GDP showed a large improvement at a twice-revised 3.9% (annualised). This was largely due to a broad recovery in corporate investment alongside a stronger performance from consumer and government spending and construction and exports. With the Fed's decision on US interest rate dependent upon data, GDP is clearly supportive. However it is not as simple as that and the Fed are keen to see inflation rise alongside its headline economic growth and also its labour markets. The Committee decided not to act at its September meeting as many had been anticipating but have signalled rates rising before the end of the year.

Market reaction: Equity markets initially reacted positively to the pickup in the expectations of global economic conditions, but were tempered by the breakdown of creditor negotiations in Greece. China led stock market turmoil around the globe in August, with the FTSE 100 falling by around 8% overnight on 'Black Monday'. Indices have not recovered to their previous levels but some improvement has been seen. Government bond markets were quite volatile with yields rising (i.e. prices falling) initially as the risks of deflation seemingly abated. Thereafter yields fell on the outcome of the UK general election and assisted by reappraisal of deflationary factors, before rising again. Concerns around China saw bond yields dropping again through August and September. Bond markets were also distorted by the size of the European Central Bank's QE programme, so large that it created illiquidity in the very markets in which it needed to acquire these bonds, notably German government bonds (bunds) where yields were in negative territory.

APPENDIX B

Compliance with Prudential Indicators

(a) Gross Debt and the Capital Financing Requirement

This is a key indicator of prudence. In order to ensure that over the medium term debt will only be for a capital purpose, the local authority should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years.

If in any of these years there is a reduction in the capital financing requirement, this reduction is ignored in estimating the cumulative increase in the capital financing requirement which is used for comparison with **gross** external debt.

The Head of Finance reports that the Authority had no difficulty meeting this requirement in 2014/15 and 2015/16 (to date), nor are there any difficulties envisaged for future years. This view takes into account current commitments, existing plans and the proposals in the approved budget.

(b) Estimates of Capital Expenditure

This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits and, in particular, to consider the impact on Council Tax and in the case of the HRA, housing rent levels.

Capital Expenditure	2015/16 Approved £m	2015/16 Revised £m	2016/17 Estimate £m	2016/17 Revised £m	2017/18 Estimate £m	2017/18 Revised £m
Total	**39.9**	**25.0**	**27.8**	**38.8**	**20.1**	**19.6**

Capital expenditure will be financed or funded as follows:

Capital Financing	2015/16 Approved £m	2015/16 Revised £m	2016/17 Estimate £m	2016/17 Revised £m	2017/18 Estimate £m	2017/18 Revised £m
Capital Receipts	2.7	0.3	4.1	5.3	0.4	0.5
General Capital Grant	2.4	2.5	2.2	2.3	2.2	2.2
Other Specific Grants	13.5	9.6	9.2	15.5	3.2	0.3
S106 Contributions	2.1	1.6	0	1.0	0	0
Revenue Contributions	0	0.1	0	0	0	0
Total Financing	**20.7**	**14.1**	**15.5**	**24.1**	**5.8**	**3.0**
Supported borrowing	4.0	4.0	3.7	3.7	3.6	3.6
Unsupported borrowing	15.1	6.9	8.2	10.5	10.6	12.9
Finance Leases	0.1	0	0.4	0.5	0.1	0.1
Total Funding	**19.2**	**10.9**	**12.3**	**14.7**	**14.3**	**16.6**
Total Financing and Funding	**39.9**	**25.0**	**27.8**	**38.8**	**20.1**	**19.6**

The table above shows that the capital expenditure plans of the Authority cannot be funded entirely from sources other than external borrowing.

(c) Ratio of Financing Costs to Net Revenue Stream:

This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs. The definition of financing costs is set out in the Prudential Code.

The ratio is based on costs net of investment income.

Ratio of Financing Costs to Net Revenue Stream	2015/16 Approved %	2015/16 Revised %	2016/17 Estimate %	2017/18 Estimate %	2018/19 Estimate %
Total	8.9	8.0	7.7	8.1	8.3

(d) Capital Financing Requirement

The Capital Financing Requirement (CFR) measures the Authority's underlying need to borrow for a capital purpose. The calculation of the CFR is taken from the amounts held in the Balance Sheet relating to capital expenditure and financing.

Closing Capital Financing Requirement	2015/16 Actual £m	2015/16 Estimate £m	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m
Total CFR	280.7	278.7	280.2	283.0	282.2

(e) Incremental Impact of Capital Investment Decisions

This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax and Housing Rent levels. The incremental impact is calculated by comparing the total revenue budget requirement of the current approved capital programme with an equivalent calculation of the revenue budget requirement arising from the proposed capital programme.

Incremental Impact of Capital Investment Decisions	2015/16 £	2016/17 Estimate £	2017/18 Estimate £	2018/19 Estimate £
Increase in Band D Council Tax*	(0.19)	0.42	6.69	5.26

Assumes a 4.0% cumulative increase in Council Tax although no decision has been taken to this effect.

(f) Authorised Limit and Operational Boundary for External Debt

The Local Government Act 2003 requires the Authority to set an 'Authorised Borrowing Limit', irrespective of their indebted status. This is a statutory limit which should not be breached.
The 'Operational Boundary' is based on the same estimates as the Authorised Limit but reflects the most likely, prudent but not worst case scenario without the additional headroom included within the Authorised Limit.
The Authority confirms that there were no breaches to the Authorised Limit and the Operational Boundary during 2014/15 to date:

	Authorised Limit 2015/16 £000s	Authorised Limit 2016/17 £000s	Operational Boundary 2015/16 £000s	Operational Boundary 2016/17 £000s	Actual Debt as at 30/09/2015 £000s	Estimated Debt as at 31/03/2015
Borrowing	299,000	306,000	269,000	276,000	212,813	242,813
Other Long-term Liabilities	49,000	47,000	49,000	47,000	51,201	51,201
Total	**348,000**	**353,000**	**318,000**	**323,000**	**264,014**	**294,014**

(g) Adoption of the CIPFA Treasury Management Code

This indicator demonstrates that the Authority has adopted the principles of best practice.

Adoption of the CIPFA Code of Practice in Treasury Management
The Council approved the adoption of the CIPFA Treasury Management Code at its Council meeting on 29th June 2009.

The Authority has incorporated the changes from the revised CIPFA Code of Practice into its treasury policies, procedures and practices.

(h) Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure

- These indicators allow the Authority to manage the extent to which it is exposed to changes in interest rates.
- The upper limit for variable rate exposure allows for the use of variable rate debt to offset exposure to changes in short-term rates on our portfolio of investments.

	Approved Limits for 2015/16 £/%	Maximum during 2015/16 £/%
Upper Limit for Fixed Rate Exposure	100%	100%
Compliance with Limits:		Yes
Upper Limit for Variable Rate Exposure	50%	0%
Compliance with Limits:		Yes

(i) Maturity Structure of Fixed Rate Borrowing

This indicator is to limit large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates.

Maturity Structure of Fixed Rate Borrowing	Upper Limit %	Lower Limit %	Actual Fixed Rate Borrowing as at 30/9/2015 £000s	% Fixed Rate Borrowing as at 30/9/2015	Compliance with Set Limits?
under 12 months	40%	0%	27,297	13%	Yes
12 months and within 24 months	20%	0%	40,997	19%	Yes
24 months and within 5 years	70%	0%	43,065	20%	Yes
5 years and within 10 years	50%	0%	33,133	16%	Yes
10 years and within 20 years	30%	0%	15,311	7%	Yes
20 years and within 30 years	20%	0%	16,950	8%	Yes
30 years and within 40 years	20%	0%	5,000	2%	Yes
40 years and within 50 years	20%	0%	16,058	8%	Yes
50 years and above	20%	0%	15,000	7%	Yes
Total			**212,811**		

(The 2011 revision to the CIPFA Treasury Management Code now requires the prudential indicator relating to Maturity of Fixed Rate Borrowing to reference the maturity of LOBO loans to the earliest date on which the lender can require payment, i.e. the next call date[1])

[1] Page 15 of the Guidance Notes to the 2011 CIPFA Treasury Management Code

(j) Upper Limit for Total principal sums invested for periods longer than 364 days

The purpose of this limit is to contain exposure to the possibility of loss that may arise as a result of the Authority having to seek early repayment of the sums invested.

Upper Limit for total principal sums invested over 364 days	2015/16 Approved	30/9/2015 Actual £000s	31/03/2016 Estimate £000s	31/03/17 Estimate £000s
TOTAL	4,000	0	4,000	4,000

APPENDIX C

Loan Debt Activity – 1 April 2015 – 30 September 2015

Newport City Council Debt	**Outstanding as at 31/03/14 £000's**	**Debt Raised £000's**	**Debt Repaid £000's**	**Outstanding as at 30/09/2015 £000's**
Public Works Loans Board	70,131	21,535	16,830	74,836
Market Loans	35,000	0	0	35,000
Stock Issue	40,000	0	0	40,000
Other Soft Loans (IFRS)	305	0	303	2
Queensbury Real Estate Debt **	34,975	25,000	0	59,975
Total Long Term Loans	**180,411**	46,535	17,133	**209,813**
Temporary Debt*	10,000	56,960	63,960	3,000
Total Long Term and Temporary Debt	**190,411**	**103,495**	**81,093**	**212,813**

* The temporary debt relates to the normal activities of the Council

**This relates to additional borrowing undertaken to fund the Newport City Centre redevelopment between the Council and Queensberry Real Estate (Newport) Ltd.

Total Investments Administered Newport City Council	**Outstanding as at 31/03/14 £000's**	**Raised £000's**	**Repaid £000's**	**Outstanding as at 30/09/2015 £000's**
Total	**2,560**	**272,090**	**270,935**	**3,715**

APPENDIX D

COUNTERPARTY LIMITS FOR BANKING – UK INSTITUTIONS

			Total Investments below £10million		Total Investments above £10million - minimum of 4 Counterparties required	
Instrument	**Country/ Domicile**	**Counterparty - Banking UK Institutions**	**Maximum Counterparty Limit and Group Limit (if applicable)**		**Maximum Counterparty Limit and Group Limit (if applicable)**	**Maximum Lending Period**
Term Deposits/ Call Accounts/ CDs	UK	Santander UK Plc. (Banco Santander Group)	£4,000,000		£8,000,000 or 50% of outstanding investments	6 Months
Term Deposits/ Call Accounts/ CDs	UK	Bank of Scotland/ Lloyds TSB (Lloyds Banking Group)	£4,000,000		£8,000,000 or 50% of outstanding investments	13 Months
Term Deposits/ Call Accounts/ CDs	UK	Barclays Bank Plc.	£4,000,000		£8,000,000 or 50% of outstanding investments	100 Days
Term Deposits/ Call Accounts/ CDs	UK	HSBC Bank Plc.	£4,000,000		£8,000,000 or 50% of outstanding investments	13 Months
Term Deposits/ Call Accounts/ CDs	UK	Nationwide Building Society	£4,000,000		£8,000,000 or 50% of outstanding investments	6 Months
Term Deposits/ Call Accounts/ CDs	UK	Royal Bank of Scotland/ National Westminster Bank (Royal Bank of Scotland Group)	£4,000,000		£8,000,000 or 50% of outstanding investments	35 Days
Term Deposits/ Call Accounts/ CDs	UK	Standard Chartered Bank	£4,000,000		£8,000,000 or 50% of outstanding investments	6 months