WOKINGHAM BOROUGH COUNCIL

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Treasury Management Strategy

Annual Treasury Management Report 2015-16

Contents

Appendices

1) Introduction and Background

The Council is required by regulations issued under the Local Government Act 2003, to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2015/16. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

During 2015/16 the Executive has received the following reports:

- The annual treasury strategy at its meeting on the 19th February 2015.
- A mid-year treasury update report at its meeting on the 28th January 2016.
- This report provides the annual review following the end of the year describing the activity compared to the strategy.

The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is therefore, important in that respect as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members.

The Council confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Audit Committee before they were reported to the full Council.

This report summarises the following:-

- Capital activity during the year;
- Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement);
- The actual prudential and treasury indicators;
- Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances;
- Summary of interest rate movements in the year;
- Detailed debt activity;
- Detailed investment activity

2) The Council's Capital Expenditure and Financing 2015/16

The Council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need or:
- Funded by borrowing (Internal or External).

The actual capital expenditure forms one of the required prudential indicators. The tables below show the actual capital expenditure.

Table 2.1

General Fund	2014/15 Actual £'000	2015/16 Budget £'000	2015/16 Actual £'000
Capital expenditure	38,774	102,341	42,237
Financed in year	(28,218)	(54,670)	(20,650)
Unfinanced Capital Expenditure	10,556	47,671	21,587

Note: The variance between actual and budget was due, in the main, to slippage in the additional places for schools programme, Wokingham Housing Limited and several large transport infrastructure schemes.

Table 2.2

HRA	2014/15 Actual £'000	2015/16 Budget £'000	2015/16 Actual £'000
Capital expenditure	6,561	8,969	4,557
Financed in year	(6,561)	(8,969)	(4,557)
Unfinanced Capital Expenditure	0	0	0

Note: The variance between actual and budget was due to a decrease in the programme due to capacity issues.

3) The Council's Overall Borrowing Need

The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's indebtedness. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represents the 2015/16 unfinanced capital expenditure (see tables 2.1 and 2.2 on the previous page), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the Government, through the Public Works Loan Board [PWLB] or the money markets) or utilising temporary cash resources within the Council.

The Council's (non HRA) underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision (MRP), to reduce the CFR. This is effectively a repayment of the non-Housing Revenue Account (HRA) borrowing need (there is no statutory requirement to reduce the HRA CFR). This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

The total CFR can also be reduced by:

- The application of additional capital financing resources (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

The Council's 2015/16 MRP Policy (as required by Communities and Local Government (CLG) Guidance) was approved as part of the Treasury Management Strategy Report for 2015/16 on 19th February 2015.

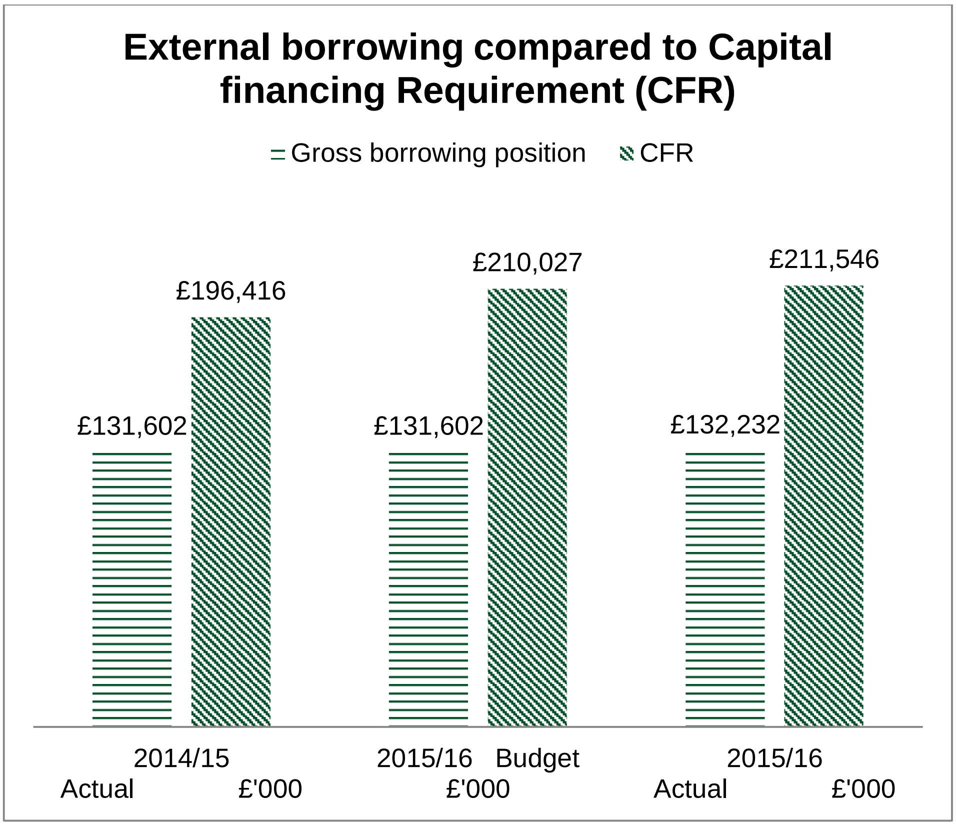
The Council's CFR for the year is shown below and represents a key prudential indicator. It includes PFI and leasing schemes on the balance sheet, which increase the Council's borrowing need. However, no borrowing is actually required against these schemes as a borrowing facility is included in the contract.

CFR: General Fund	2014/15 Actual £'000	2015/16 Budget £'000	2015/16 Actual £'000
Opening balance	95,255	102,795	101,948
Add unfinanced capital expenditure (as above)	9,964	16,881	20,152
Less MRP/VRP	(3,024)	(3,310)	(3,024)
Less PFI & finance lease repayments	(247)	(215)	(264)
Closing balance	101,948	116,151	118,812

CFR : HRA	2014/15 Actual £'000	2015/16 Budget £'000	2015/16 Actual £'000
Opening balance	93,876	93,876	93,876
Add unfinanced capital expenditure (as above)	0	0	0
Repayment of Loan Principal	0	0	912
Closing balance	93,876	93,876	92,964

Borrowing activity is constrained by prudential indicators for net borrowing and the CFR and by the authorised limit.

In order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (plus the estimates of any additional capital financing requirement for the current and next two financial years). This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs. The bar chart below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.



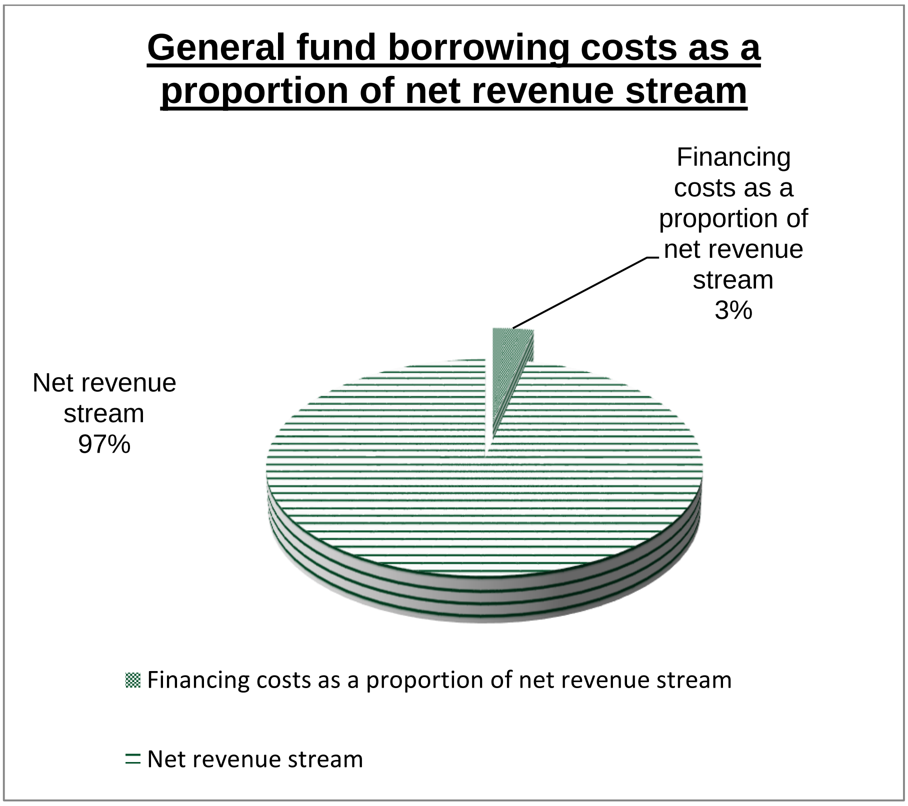
The authorised limit is the “affordable borrowing limit” required by section 3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level.

The operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary is acceptable subject to the authorised limit not being breached.

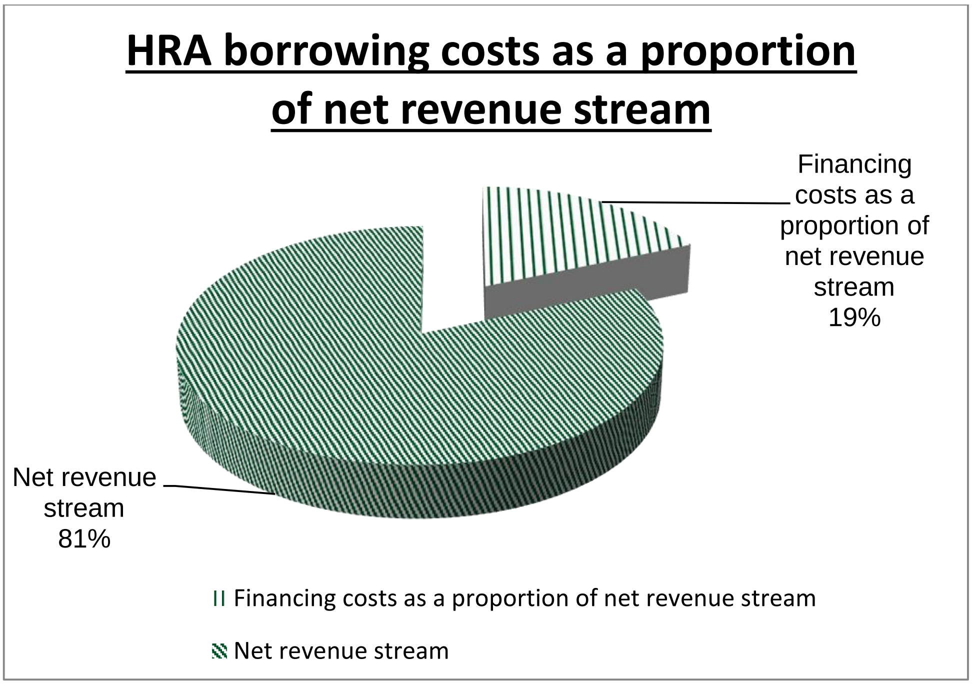
The table below demonstrates that during 2015/16 the Council has maintained gross borrowing within its authorised limit and operational boundary.

	2015/16 £'000	2015/16 Actual £'000	Variance £'000
Authorised limit	**223,000**	**132,232**	**90,768**
Operational boundary	**200,000**	**132,232**	**67,768**

Actual financing costs as a proportion of net revenue stream - this indicator identifies the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream (see tables below).



The graph above demonstrates that 3% of the councils revenue budget is set aside to service debt financing costs (i.e. external interest on loans)



The graph on the previous page demonstrates that 19% of the HRA revenue budget is set aside to service debt financing costs (i.e. external interest on loans).

4) Treasury Position as at 31st March 2016

The Council's debt and investment position is organised by the treasury management service in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through member reporting detailed in the summary, and through officer activity detailed in the Council's Treasury Management Practices. At the beginning and the end of 2015/16 the Council's treasury (excluding borrowing by PFI and finance leases) position was as follows:

General fund	31 March 2015 Principal £'000	Rate/ Return %	31 March 2016 Principal £'000	Rate/ Return %
Fixed rate funding:	**23,151**		**23,781**	
-PWLB	**23,031**	**4.49%**	**23,031**	**4.49%**
-Market	**0**		**0**	
-Local Enterprise Partnership (interest free)	**120**		**750**	
Variable rate funding:	**23,433**		**23,433**	
-PWLB	**0**		**0**	
-Market	**23,433**	**4.27%**	**23,433**	**4.27%**
Total debt	**46,584**		**47,214**	

HRA	31 March 2015 Principal £'000	Rate/ Return %	31 March 2016 Principal £'000	Rate/ Return %
Fixed rate funding:	**84,451**		**84,451**	
-PWLB	**84,451**	**2.85%**	**84,451**	**2.85%**
-Market	**0**		**0**	
Variable rate funding:	**567**		**567**	
-PWLB	**0**		**0**	
-Market	**567**	**4.28%**	**567**	**4.28%**
Total debt	**85,018**		**85,018**	

Average return on Investments (Cumulative)	1st Qtr %	2nd Qtr %	3rd Qtr %	4th Qtr %
Aberdeen Asset Management	0.16	0.33	0.55	0.74
Royal London Asset Management	0.06	0.17	0.33	0.49
In-house*	0.29	0.58	0.86	1.15
Total (Weighted Average)	0.24%	0.49%	0.74%	1.01%

'*This includes internal loans to the HRA and WBC companies (see appendix B)

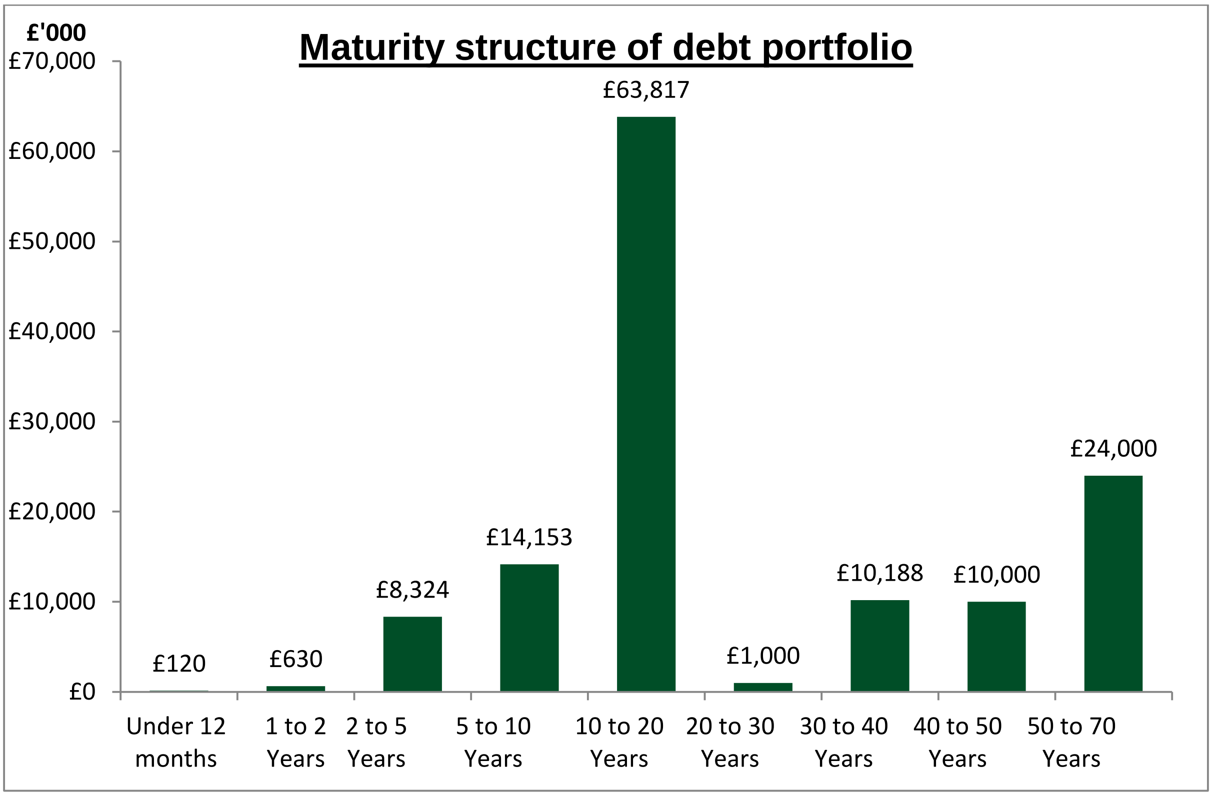
<u>Portfolio Valuation as at 31 March 2016</u>

Portfolio Valuation as at 31 March 2016 (completed by Capita Asset Services)	Nominal / Principal £'000	Fair Value £'000
Investments		
Fixed Term Deposits	30,000	30,085
Total	30,000	30,085
External Debt		
LOBO loan - Fixed rate	24,000	32,485
PWLB loan - Maturity	107,482	119,040
Local Enterprise Partnership loan	750	750
Total	132,232	152,275

* Fair value is a rational and unbiased estimate of the potential market price of goods/services.

The purpose of the valuation is to evaluate quantitatively the authority's financial position and performance with regard to each class of financial instrument, and also to indicate the extent of the authority's risk exposure arising as a result of these transactions.

The maturity structure of the debt portfolio was as follows:



The maturity structure of the investment portfolio was as follows:

	2014/15 Actual £'000	2015/16 Budget £'000	2015/16 Actual £'000
Investments			
Longer than 1 year	0	10,000	0
Under 1 year	59,735	40,000	51,544
Total	**59,735**	**50,000**	**51,544**

The exposure to fixed and variable rates was as follows:

	2014/15 Actual £'000	2015/16 Budget £'000	2015/16 Actual £'000
Interest rate exposures: Debt			
Upper limit on fixed rate exposures - Net Position	107,602	180,000	107,482
Upper limit on variable rate exposures - net position	24,000	40,000	24,000

Note: The variance between actual and budget was due, in the main, to the Town centre slippage (Anticipated loan not required of £14.5m) and Slippage in Wokingham Housing Limited (Anticipated loan not required of £17.1m)

	2014/15 Actual £'000	2015/16 Budget £'000	2015/16 Actual £'000
Interest rate exposures: Investment			
Upper limit on fixed rate exposures - Net Position	**(48,867)**	**(80,000)**	**(39,114)**
Upper limit on variable rate exposures - net position	**(9,546)**	**(40,000)**	**(12,430)**

Note: The actuals fluctuate during the year depending on the cash flow available for investment.

5) The Treasury Strategy for 2015/16

The expectation for interest rates within the strategy for 2015/16 anticipated a low but rising Bank Rate (starting in quarter 1 of 2016) and gradual rises in medium and longer term fixed borrowing rates during 2015/16. Variable or short-term rates were expected to be the cheaper form of borrowing over the period. Continued uncertainty in the aftermath of the 2008 financial crisis promoted a cautious approach whereby investments would continue to be dominated by low counterparty risk considerations resulting in relatively low returns compared to borrowing rates.

In this scenario, the treasury strategy was to postpone external borrowing to avoid the cost of holding higher levels of investments and to reduce counterparty risk. This is demonstrated by an increase in internal borrowing of 4.95% since 2014/15. Internal borrowing as at 31st March 2016 stands at 33% of the CFR. (See appendix B)

Although this has increased our internal borrowing, this has generated a larger saving on external borrowing interest costs.

As mentioned above the internal borrowing is evaluated thought out the year to help in calculating when it would be financially beneficial to take out external loans.

6) The Economy and Interest Rates

Market expectations for the first increase in Bank Rate moved considerably during 2015/16, starting at quarter 3, 2015 but soon moving back to quarter 1, 2016. However, by the end of the year, market expectations had moved back radically to quarter 2, 2018 due to many fears including concerns that China's economic growth could be heading towards a hard landing; the potential destabilisation of some emerging market countries particularly exposed to the Chinese economic slowdown and the continuation of the collapse in oil prices during 2015 together with continuing Eurozone growth uncertainties.

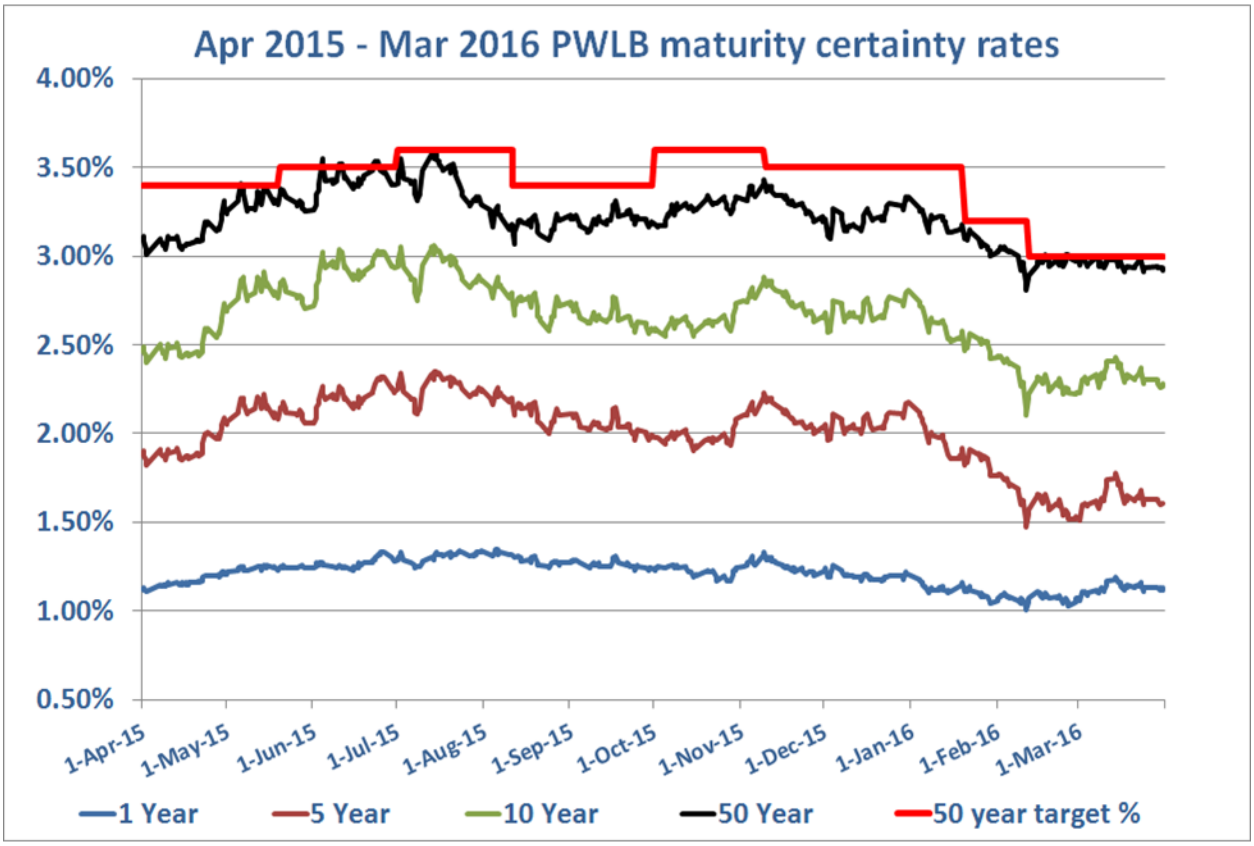
Economic growth (GDP) in the UK surged strongly during both 2013/14 and 2014/15 to make the UK the top performing advanced economy in 2014. However, UK growth in 2015 has been disappointing, falling steadily from an annual rate of 2.9% in quarter 1, 2015 to 2.1% in quarter 4. The Funding for Lending scheme, announced in July 2012, resulted in a flood of cheap credit being made available to banks which resulted in money market investment rates falling materially. These rates continued at very low levels during 2015/16.

The sharp volatility in equity markets during the year was reflected in sharp volatility in bond yields. However, the overall dominant trend in bond yields since July 2015 has been for yields to fall to historically low levels as forecasts for inflation have repeatedly been revised downwards and expectations of increases in central rates have been pushed back. In addition, a notable trend in the year was that several central banks introduced negative interest rates as a measure to stimulate the creation of credit and hence economic growth.

The UK elected a majority Conservative Government in May 2015, removing one potential concern but introducing another due to promise of a referendum on the UK remaining part of the EU on the 23rd June 2016. The government maintained its tight fiscal policy stance but the more recent downturn in expectations for economic growth has made it more difficult to return the public sector net borrowing to a balanced annual position within the period of this parliament.

7) Borrowing Rates in 2015/16

The graph for PWLB certainty maturity rates is shown below, for a selection of maturity periods, the high and low points in rates, the average rates spreads and individual rates at the start and the end of the financial year.



8) Borrowing Outturn for 2015/16

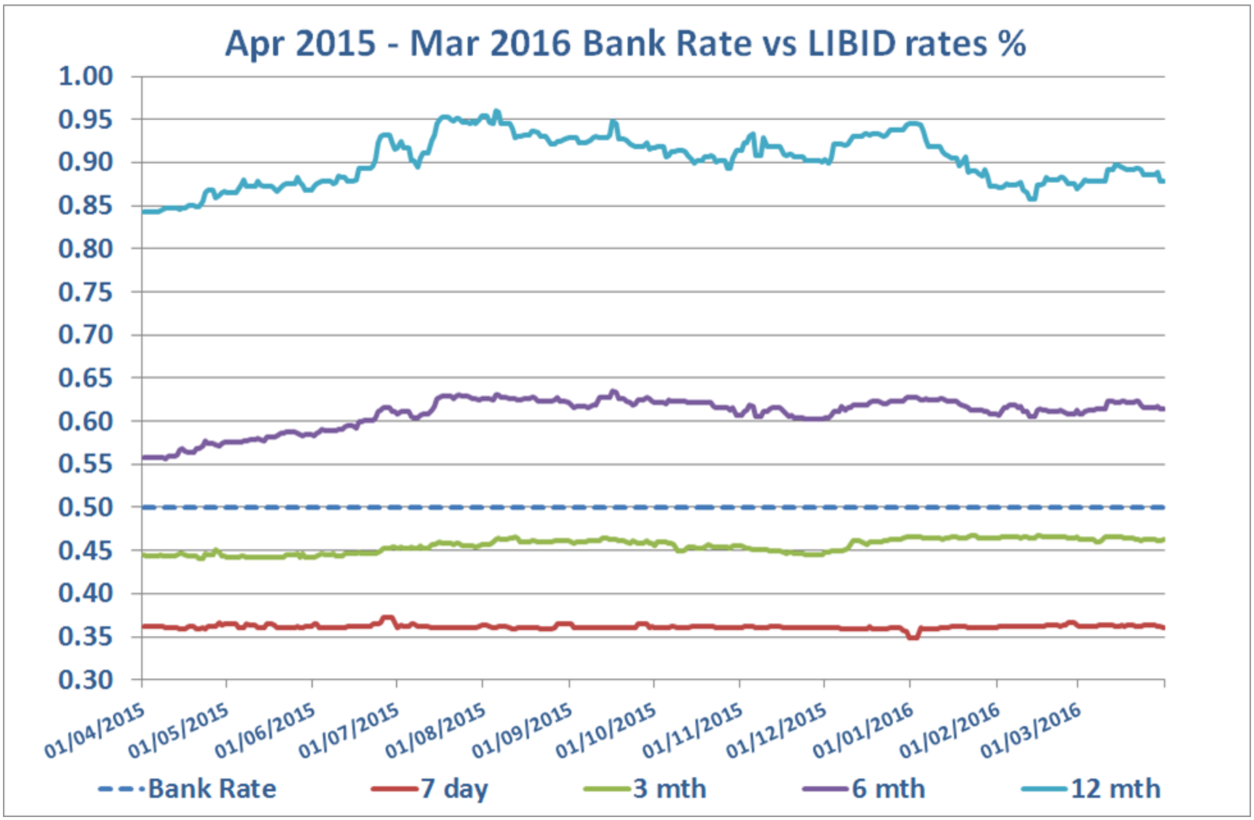
Borrowing

During 2015/16 no new PWLB and market Loans have been taken out. £630,000 of Local Enterprise partnership interest free loans were taken out.

Repayments – No repayments were actioned in 2015/16

9) Investment Rates in 2015

The Bank Rate remained at its historic low of 0.5% throughout the year; it has now remained unchanged for six years. Market expectations as to the timing of the start of monetary tightening started the year at quarter 1 2016 but then moved back to around quarter 3 2017 by the end of the year. Deposit rates remained depressed during the whole of the year, primarily due to the effects of the Funding for Lending Scheme.



10) Investment Outturn for 2015/16

The Council's investment policy is governed by CLG guidance, which was implemented in the annual investment strategy approved by the Council on 19th February 2015. This policy sets out the approach for choosing investment counterparties and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc.).

The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

Interest received from Investments held by the Council

	2015-16 Budget As per the TMSS £'000	2015/16 Actual £'000	%
Interest on investments			
RLAM		**60**	**7.0%**
Aberdeen Asset Management *		**70**	**8.2%**
In House **		**729**	**84.8%**
Total	**726**	**859**	**100%**

Note:* Aberdeen asset Management formerly known as Scottish Widows Investment Partnership (SWIP)

Note ** includes internal loans to Wokingham Housing Limited and HRA

11) Performance Measurement

One of the key requirements in the Code is the formal introduction of performance measurement relating to investments, debt and capital financing activities. Whilst investment performance criteria have been well developed and universally accepted, debt performance indicators continue to be a more problematic area with the traditional average portfolio rate of interest acting as the main guide. The Council's performance indicators were set out in the Annual Treasury Management Strategy.