WOKINGHAM BOROUGH COUNCIL

Treasury Management Strategy

Mid-year Review Report 2015/16

Contents

Appendices

1) Introduction and Background

a) The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously borrowed may be restructured to meet Council risk or cost objectives.

b) The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management has been adopted by Wokingham Borough Council

The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.

3. Receipt by the full council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a **Mid-year Review Report** and an Annual Report covering activities of the previous year.

4. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

5. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this the Council's delegated body is the Audit Committee.

2) This report summarises the following:-

- **a.** An economic update for the 2015/16 financial year to 30 September 2015;
- **b.** A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- **c.** The Council's capital expenditure (prudential indicators);
- **d.** A review of the Council's investment portfolio for 2015/16;
- **e.** A review of the Council's borrowing strategy for 2015/16;
- **f.** A review of any debt rescheduling undertaken during 2015/16;
- **g.** A review of compliance with Treasury and Prudential Limits for 2015/16.

3) Economic update

3.1 Economic performance to date and outlook

After strong growth in 2014 this has been varied in 2015. Quarter 1 was weak but rebounded in quarter 2. The weak growth in Europe and emerging markets and dampening effect of the Government's continuing austerity programme is expected to give weaker growth in Quarter 3.

In contrast the Bank of England August Inflation Report had included a forecast for growth to remain around 2.4 – 2.8% over the next three years, driven mainly by strong consumer demand as the squeeze on the disposable incomes of consumers has been reversed by a recovery in wage inflation at the same time that CPI inflation has fallen to, or near to, zero over the last quarter. Investment expenditure is also expected to support growth. However, since the report was issued, the Purchasing Manager's Index, (PMI), for services on 5 October indicated a further decline in the growth rate to only +0.3% in Q4, which is the lowest rate since the end of 2012. In addition, worldwide economic statistics and UK consumer and business confidence have distinctly weakened so it would therefore not be a surprise if the next Inflation Report in November were to cut those forecasts made in August.

The August Bank of England Inflation Report forecast was notably subdued in respect of inflation which was forecast to barely get back up to the 2% target within the 2-3 year time horizon. However, with the price of oil taking a fresh downward direction and Iran expected to soon rejoin the world oil market after the impending lifting of sanctions, there could be several more months of low inflation still to come, especially as world commodity prices have generally been depressed by the Chinese economic downturn.

There are therefore considerable risks around whether inflation will rise in the near future as strongly as had previously been expected; this will make it more difficult for the central banks of both the US and the UK to raise rates as soon as was being forecast until recently, especially given the recent major concerns around the slowdown in Chinese growth, the knock on impact on the earnings of emerging countries from falling oil and commodity prices, and the volatility we have seen in equity and bond markets in 2015 so far, which could potentially spill over to impact the real economies rather than just financial markets.

3.2 Interest rate forecasts

Wokingham Borough Council's treasury advisor, Capita Asset Services, has provided the following forecast:

*Includes Certainty Rate Discount

Interest Rate Forecasts								
Bank Rate								
	Q4 15	Q1 16	Q2 16	Q3 16	Q4 16	Q1 17	Q2 17	Q3 17
Capita	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.50%
Capital Eco.	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%
5yr PWLB Rate								
Capita	2.30%	2.40%	2.60%	2.70%	2.80%	2.80%	2.90%	3.00%
Capital Eco.	2.40%	2.60%	2.70%	2.80%	3.00%	3.10%	3.20%	3.30%
10yr PWLB Rate								
Capita	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.60%
Capital Eco.	2.80%	3.05%	3.05%	3.05%	3.30%	3.30%	3.55%	3.55%
25yr PWLB Rate								
Capita	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.10%	4.20%
Capital Eco.	3.35%	3.35%	3.45%	3.45%	3.55%	3.65%	3.75%	3.85%
50yr PWLB Rate								
Capita	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%
Capital Eco.	3.40%	3.40%	3.50%	3.50%	3.60%	3.70%	3.80%	3.90%

This latest forecast includes a first increase in Bank Rate in quarter 2 of 2016. Given the anticipated rise in the interest rate the treasury function will review WBC position on longer term external borrowing as opposed to a dependence on internal funds.

4) Treasury Management Strategy Statement and Annual Investment Strategy update

The Treasury Management Strategy Statement (TMSS) for 2015/16 was approved by the Council on 19th of February 2015

- There are no policy changes to the TMSS; the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

5) The Council's Capital Position (Prudential Indicators)

This part of the report is structured to update:

- The Council's capital expenditure plans;
- How these plans are being financed;
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity.

5.1 The Council's Capital Position (Prudential Indicators)

The Table below shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the Budget.

Service	2015/16 Budget As per the TMSS	Budget As per Capital Programme @ 30/09/2015	Movement
Children's Services	27,474	30,748	3,274
Health and Wellbeing	15,710	23,381	7,671
Environment	16,995	19,787	2,792
Finance & Resources	9,490	5,282	(4,208)
Chief Executive	18,112	18,399	287
Subtotal (Non HRA)	87,781	97,599	9,818
Housing revenue Account (HRA)	8,064	9,937	1,873
Subtotal (HRA)	8,064	9,937	1,873
Grand Total	95,845	107,536	11,691

The budget of £107.5m is an increase of £11.7m from the original budget agreed in the TMSS. The movement is due to £0.5m of additional WBC resources (section 106 etc.) and the actual 2014/15 carry forward being £11.2m higher than estimated in TMSS.

5.2 Changes to the Financing of the Capital Programme

The table on the following page summarises how the above capital budget are being financed by capital or revenue resources and the movement since the TMSS was agreed. Any shortfall of resources results in a funding need.

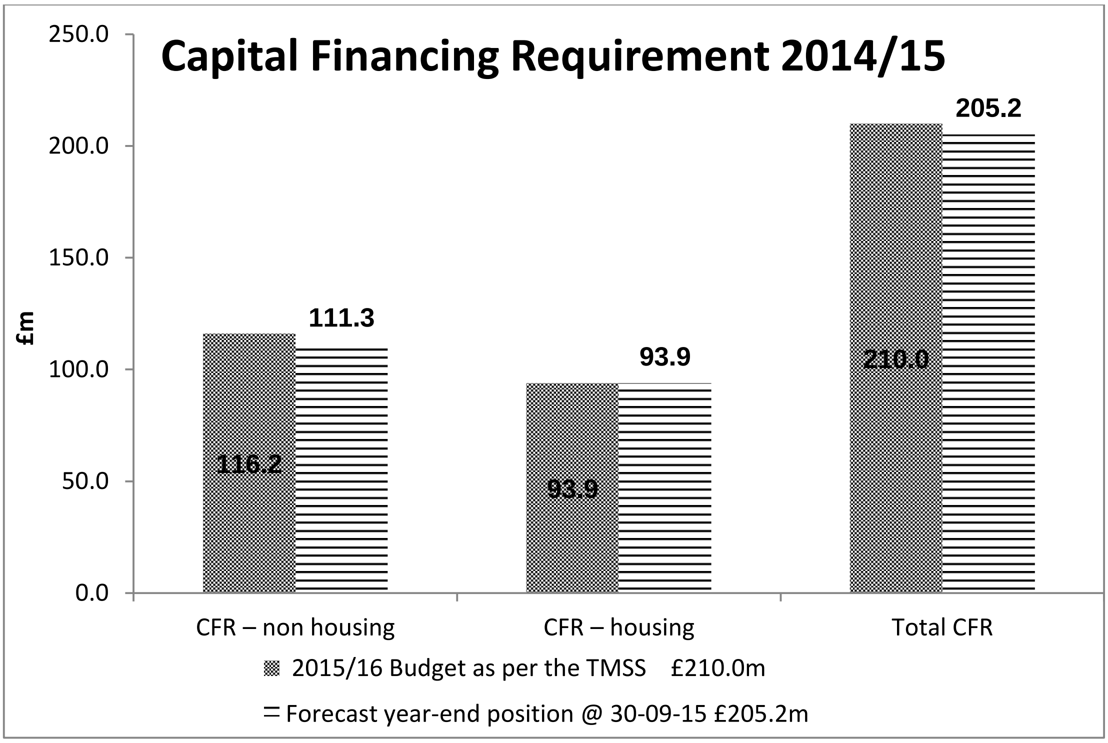
Funding Source		2015/16 Budget As per the TMSS £'000	Budget As per Capital Programme @ 30/09/2015 £'000
HRA - major repairs reserve		4,220	4,220
Capital Grants & Contributions		3,844	4,749
Capital Receipts/Reserves			968
Subtotal (HRA)		8,064	9,937
NON -HRA			
Capital Receipts/Reserves		2,837	4,743
Section 106		21,547	23,920
Capital Grants & Contributions		24,587	28,171
Community infrastructure Levy		0	0
Subtotal (Non HRA)		48,971	56,835
Borrowing need for the year *		38,810	40,764
Grand Total		95,845	107,536

*** Net financing (borrowing) is funded by either external borrowing (PWLB loans etc.) or internal borrowing (use of cash flow funds).**

This is not an increase in cumulative borrowing; it is as a result of expenditure movement between 2014/15 and 2015/16.

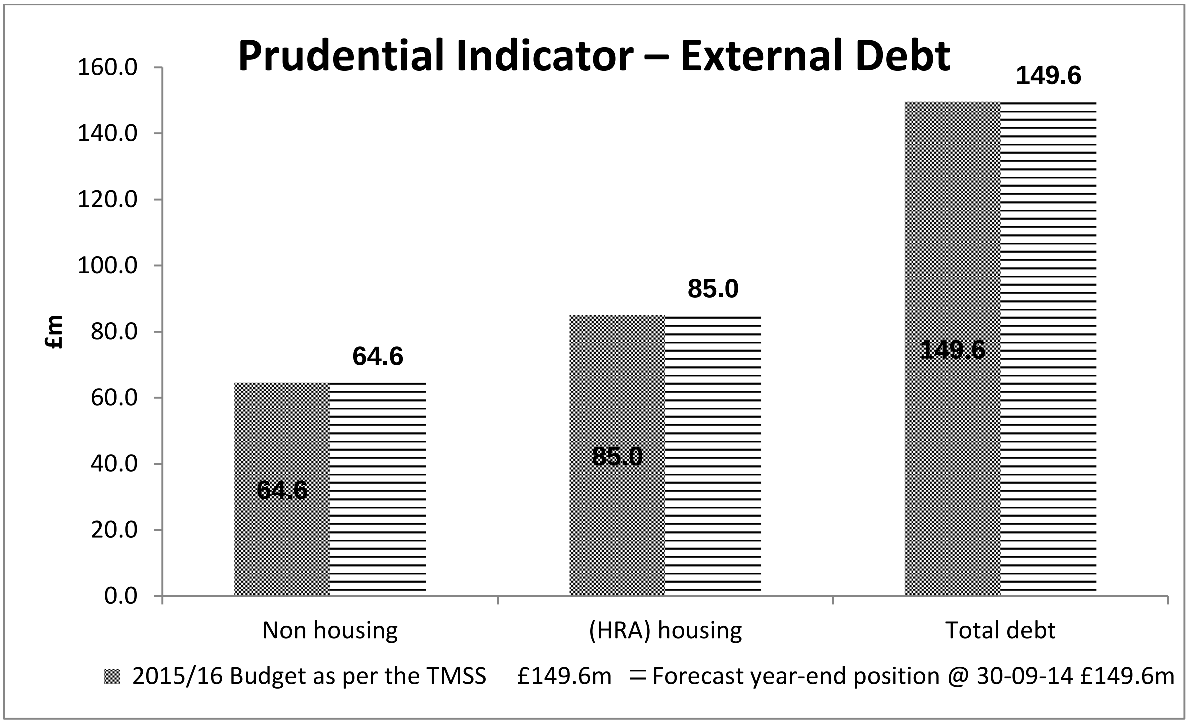
5.3.1 Changes to the Prudential Indicators for the Capital Financing Requirement (CFR)

The following graphs and tables show the CFR, which is the underlying external need to incur borrowing for a capital purpose up until 31st March 2016 as estimated at 30th September 2015 compared to the Treasury Management Strategy 2015/16 (TMSS).



5.3.2 Changes to the Prudential Indicators External Debt

The following graph shows the changes to external debt position 2015/16 up until 31st March 2016 estimated at the 30th September 2015 compared to the Treasury Management Strategy 2015/16 (TMSS).



5.4 Limits to Borrowing Activity

The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2015/16 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

Prudential Indicator – External Debt	2015/16 Budget As per the TMSS £'000	Forecast year-end position @ 30-09-15 £'000
External borrowing	149,602	149,602
Plus other long term liabilities*	9,000	9,000
Gross borrowing	158,602	158,602
CFR* (year-end position)	210,027	205,198
Does gross borrowing exceed CFR?	NO	NO

* Includes on balance sheet PFI schemes and finance leases etc.

The movement between TMSS and forecast end of year position is due to the delay in progression of the Town Centre Regeneration scheme, this delay was to enable enhancement from feedback and consultation.

The operational boundary. This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

Operational boundary £'000	2015/16 As per the TMSS £'000*	External borrowing position @ 30-09-15 £'000	Forecast year-end borrowing @ 30-09-15 £'000
Debt	202,000	149,602	149,602
Other long term liabilities	10,000	9,000	9,000
Total	212,000	158,602	158,602

* Note: This is a boundary not the budget set in the accounts.

The authorised limit for external debt. A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desirable, could be afforded in the short term, but is not sustainable in the longer term.

Authorised limit £'000	2015/16 As per the TMSS £'000*	External borrowing position @ 30-09-15 £'000	Forecast year-end borrowing @ 30-09-15 £'000
Debt	210,000	149,602	149,602
Other long term liabilities	12,000	9,000	9,000
Total	222,000	158,602	158,602

* Note: This is a boundary not the budget set in the accounts.

Separately, the Council is also limited to a maximum HRA CFR through the HRA self-financing regime. This limit is currently:

	2015/16 As per the TMSS £'000*	External borrowing position @ 30-09-15 £'000	Forecast year-end borrowing @ 30-09-15 £'000
HRA Debt limit	102,000	93,892	93,892
HRA Headroom	102,000	93,892	93,892

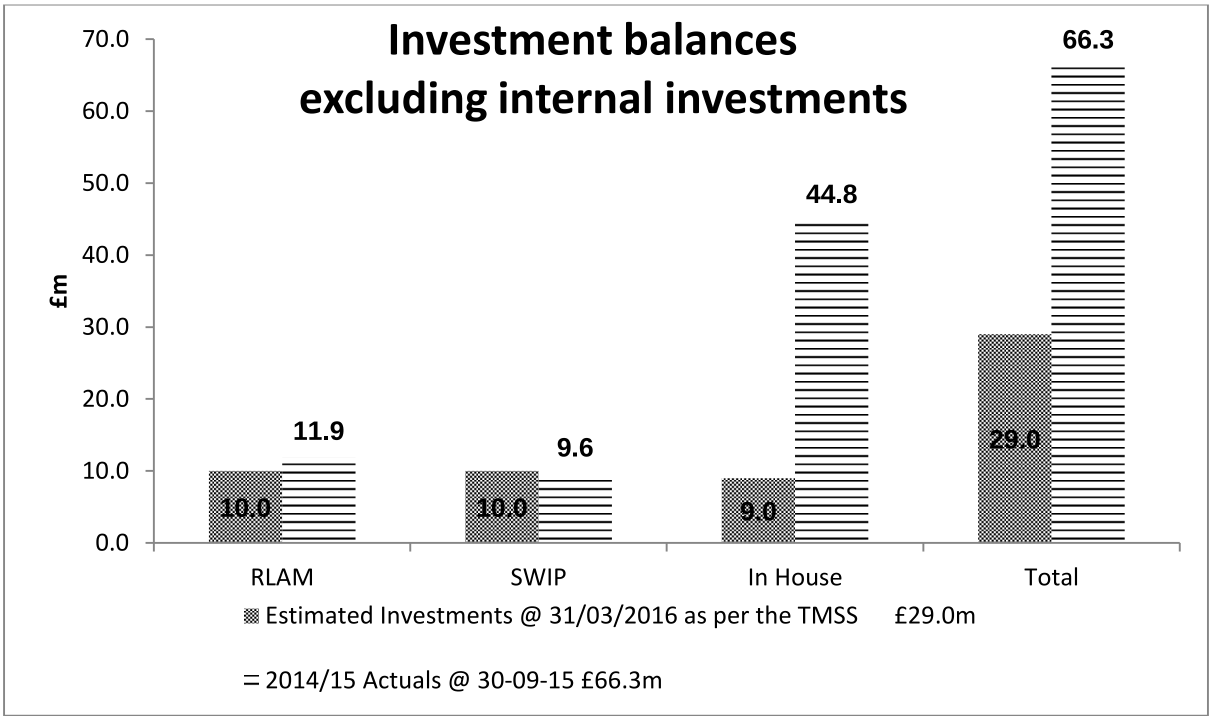
* Note: This is a boundary not the budget set in the accounts.

The Director of Finance and Resources reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

6. Investment Portfolio 2015/16

In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite. As set out in Section 3, it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low and in line with the 0.5% Bank Rate. Indeed, the introduction of the Funding for Lending scheme has reduced market investment rates even further. The potential for a prolonging of the Eurozone sovereign debt crisis, and its impact on banks, prompts a low risk and short term strategy. Given this risk environment, investment returns are likely to remain low.

The Council's Level of investments as at 30 September 2015



As at 30th September the Investment balances are £37.3m higher than the estimated 31st March balance. This is largely due to the following:

a) Grant/Receipts are received in advance of the anticipated expenditure.

b) The capital expenditure for 2014/15 was £11.2m lower than anticipated.

c) The delay in progressing the Town Centre Regeneration scheme

The levels of investments are expected to reduce by the 31st March 2016, as the council expenditure plans are met. A full list of investments held as at 30th September 2015 is shown in appendix C:

The Council's investment return for 2015/16

Investment balances excluding internal investments	2015/16 Budget As per the TMSS £'000	2015/16 Actuals @ 30-09-15 £'000
RLAM	10,000	11,887
SWIP	10,000	9,579
In House*	9,000	44,800
Total	29,000	66,266

* In house includes the following:

HRA loan at a rate of 4.5%
Wokingham Housing Limited loans at a rate 6%
Age concern loan at 1.99%

The average of In house investments excluding the internal loan is 0.45%

The Director of Finance and Resources confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2015/16.

7. Borrowing 2015/16

The Council's capital financing requirement (CFR) forecast outturn 2015/16 as at 30th September is £205.2m. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing).

The following table shows the Council has borrowings of £149.6m (external borrowing and other long term liabilities) and has utilised £46.6m of cash flow funds in lieu of borrowing (Internal Borrowing) This is a prudent and cost effective approach in the current economic climate but will require ongoing monitoring in the event that upside risk to gilt yields prevails.

Internal borrowing	2015/16 Budget As per the TMSS £'000	2015/16 Forecast year end @ 30-09-15 £'000
CFR (year-end position)	210,196	205,198
Less External Borrowing	(149,602)	(149,602)
Less Other long term liabilities	(9,000)	(9,000)
Internal Borrowing	51,594	46,596
% of internal borrowing to CFR	24.5%	22.7%

	2014/15 @31/03/15	2015/16 Forecast year end @ 30-09-15 £'000
Internal borrowing	55,838	46,596
Movement from 2014/15		(9,242)

As mentioned in section 3.2 the treasury function will review WBC position on longer term external borrowing as opposed to a dependence on internal funds. reflecting in part the expected rise in the Bank rate.

It is not anticipated that further borrowing will be required during this financial year.

8. Debt Rescheduling 2015/16

No debt rescheduling was undertaken during the first six months of 2015/16 or is proposed for the remainder of the financial year. There are forecast to be new loans taken out to the value of £18m by 31st March 2016. This will be at a special rate 40 bases point lower than the PWLB rate. (Local Enterprise Partnership Agreement).