Brent	**Cabinet** 15 August 2016 **Report from the Chief Finance Officer**
For Action	Wards Affected: ALL

2015/16 Treasury Management Outturn Report

1. INTRODUCTION

1.1 This report updates members on Treasury Management activity and confirms that the Council has complied with its Prudential Indicators for 2015/16.

2. RECOMMENDATION

2.1 Cabinet is asked to note the 2015/16 Treasury Management outturn report, which is substantively the same as reviewed at Audit Committee on 30th June, which will in turn be presented to Council, in compliance with CIPFA's Code of Practice on Treasury Management (the Code).

3. BACKGROUND

3.1 The Council's treasury management activity is underpinned by the Code, which requires authorities to produce annually Prudential Indicators and a Treasury Management Strategy Statement on the likely financing and investment activity. The Code also recommends that members are informed of treasury management activities at least twice a year.

3.2 This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the CLG Investment Guidance.

3.3 The Council has borrowed money over the long term to support investment in the Council's infrastructure and also invests balances held for short periods. It is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are central to the Council's treasury management strategy.

Economic background

3.4 The recovery in the UK continued with steady, though slowing, economic activity and growth. Q4 2016 GDP showed year-on-year growth of 2.1%, almost entirely from the service sector. The Consumer Price Index (CPI) of inflation increased to 0.5%, and is expected to increase further as the price of oil starts to rise from its current low level, but inflation is not expected to exceed the Bank of England's target this year or next. While employment is currently at a record level of 74.2% of the working age population, pay has grown at a more modest rate than in previous recoveries, limiting the potential of future economic growth. The Eurozone has maintained its low level of economic growth and geopolitical tensions seem to have diminished, though they have not completely dissipated.

3.5 Due to differing perspectives on the potential impact of the upcoming EU referendum, there is uncertainty in the marketplace. This is being monitored on a daily basis and due to consideration to reports by the Council's Treasury advisors, who recommend caution. Furthermore, potential effects of an exit from the EU are unpredictable, because they depend significantly on subsequent actions and reactions by a wide range of individuals and organisations, and it is not known how they will react till later in the calendar year. Any relevant update would need to be noted verbally at the meeting, because the impact of Brexit is a proverbial "moveable feast".

Gilt Yields and Money Market Rates

3.6 Gilt yields (the rate of interest on UK government borrowing) rose in the first quarter of 2015-16 and then fell in over the rest of the year. 10 year yields ended the year at 1.42% and 20 years at 2.14%, both slightly lower than the at the start of the year.

3.7 Interest rates on short term inter-bank lending remained below 1% through the year.

3.8 That rates will stay longer and likely lower than the current 0.5% has been suggested by the Bank of England Governor but the anticipated future rate reduction was subject to a vote at the time of this report's drafting. This reflects the current consensus in the marketplace but like all consensus, it is subject to the overriding caveat of economic uncertainty.

The Borrowing Requirement and Debt Management

3.8 The table below summarises the Council's borrowing activity during 2015/16. The Council's underlying need to borrow as measured by the Capital

Financing Requirement (CFR) at 31/03/2016 was estimated to be £612 million.

	Balance 01/04/2015 (£m)	New Borrowing (£m)	Borrowing Repaid (£m)	Balance 31/03/2016 (£m)	Average Rate (%)	Average Life (Years)
CFR	579			612		
Short Term Borrowing	0	0	0	0	0	
Long Term Borrowing	424	0	5	419	4.76	35.4

3.9 At 1 April 2015 the Council had £424 million of long-term borrowing, to finance its previous years' capital programmes. With short-term interest rates being much lower than long-term rates, it was more cost effective in the short-term to use internal resources rather than undertake further long-term borrowing. By doing so, the Council has been able to reduce net borrowing costs and reduced overall treasury risk, because overall borrowing has been reduced slightly. No temporary borrowing was required during the year. The average rate of 4.76% was higher than last year's rate of 4.72% and this was due to the redemption of £5m of PWLB loans that are paid back steadily over their lifetime.

3.10 The Treasury Management Strategy approved by the Council in February 2015 states that the Council will maintain borrowing at the lowest level consistent with prudent management of the Councils finances. This implies that, at present discount rates, we will not undertake premature repayment of debt but that, in conjunction with our Treasury Management advisers, Arlingclose, we will remain abreast of developments and be prepared to borrow up to the level of CFR if a significant permanent rate rise appears likely. These circumstances did not arise during the year.

3.11 No debt was restructured during the year and no lenders exercised options to vary the terms of loans on LOBO (Lender Option, Borrower Option) terms. The Council has borrowed £95.5m under LOBO transactions, all of which were entered into in the period November 2002 to April 2010. Unlike PWLB loans, there is no formula for the cost of redemption of LOBOs, and the price quoted would depend on any bank's view on its commercial advantage. The banks' positions have been insured through the derivatives markets and to renegotiate these arrangements would be very expensive. The average premium on our LOBO portfolio is about 68%: this would mean that it would cost £8.4m to redeem a LOBO with a nominal value of £5m. However, there is no established formula for the redemption price and the actual cost be higher.

3.12. There are complex arguments made about LOBOs, by their supporters and by their detractors. The Council's position is simply that the LOBOs are part of its portfolio, and must therefore be managed as effectively as possible. There are no plans to enter into further LOBO contracts. However, it should be noted that the average rate of interest being paid on LOBOs is little different to that on PWLB debt (4.75% compared to 4.71% at 31 March) and the range of rates lower. The most expensive LOBO was at 6.234% on 31 March, compared with the most expensive PWLB at 8.875%.

3.13 Since, the end of 2015/16, Barclay's Bank decided to give up its lender option to £15m of LOBOs. There were three loans of £5 million each, with interest rates of 3.95%, 4.35% and 4.5%, with maturities between 2048 and 2076. Barclays did this to ensure it could meet Basle III Capital Requirements that banks need to comply with by 2019. As these changes are to the borrowers' advantages, it merely needed to notify us and provide us with the signed declaration of its change. It is likely, according to Arlingclose, our Treasury advisers, that other lenders will soon follow suit.

3.14 In January 2015 the Department of Communities and Local Government (CLG) confirmed that HM Treasury (HMT) would be taking the necessary steps to abolish the Public Works Loans Board. The proposal is to transform PWLB from being an arms-length organization to being part of the Treasury in order to simplify structures in Central Government. HMT has confirmed however that its lending function will continue unaffected and local authorities will retain access to borrowing rates which offer good value for money. The authority intends to use the PWLB's replacement as a potential source of borrowing if required. As this is the sole impact of the proposals and Brent's interest is protected, Brent chose not to comment, except via Arlingclose.

Investment Activity

Investments	Balance on 01/04/2015 (£m)	Investments made (£m)	Investments repaid (£m)	Balance on 31/03/2016 (£m)	Average Rate (%)
Fixed Term Deposits	125	397	431	91	0.5
Marketable instruments		328	278	50	0.6
Money Market Funds and notice deposits	24	623	624	23	0.4
TOTAL INVESTMENTS	149	1348	1333	164	0.5

3.14 Both CIPFA and the CLG Investment Guidance require the Council to invest prudently and have regard to the security and liquidity of investments before seeking the optimum yield. The table below summarizes investment activity during 2015/16.

3.15 Security of capital remained the Council's main investment objective. This was maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2015/16 which defined "high credit quality organisations" as those having a long-term credit rating of A- or higher that are domiciled in the UK or overseas where the sovereign rating is AA+ or higher.

3.16 The growth of bail-in risk gave rise to the decision to restrict the maximum maturity with market financial institutions to three months and use only marketable instruments issued by them. Bail-in means that long-term loans in financial institutions are converted into equity (shares) that are not easily convertible for many years, preventing Brent from accessing the resources, and potentially giving them a hefty cut in their value.

3.17 New investments with banks and Building Societies have been undertaken by means of marketable instruments and the Treasury bill market has also been used. Treasury bills have largely replaced the use of the UK Debt Management Office (the Bank of England's temporary borrowing team, who are effectively a deposit taker of last resort, borrowing at 0.25%) which has been used on rare occasions to invest large receipts at short notice. The risk of bail in has recently declined for many UK institutions, but investment decisions still need to be made on a case by case basis.

Credit developments and credit risk management

3.18 The Council assessed and monitored counterparty credit quality with reference to credit ratings, credit default swaps (a means of insuring loans), perceived credit-worthiness of the country in which the institution is registered and its share price. The minimum long-term counterparty credit rating determined by the Council for the 2015/16 treasury strategy was A- across rating agencies Fitch, S&P and Moody's.

3.19 The mechanism for dealing with a failed bank, which was brought into effect through the Financial Services (Banking Reform) Act 2013, is now in operation. The Council has taken a number of actions in response to this, and continues to monitor risks, with advice from Arlingclose.

3.20 The Council did not make any deposits with institutions in the Eurozone during the year and took the action noted above on UK banks. Two very conservative Swedish banks (Svenska Handelsbanken and Nordea) were added to our lending list, with a limit of six months, in accordance with Arlingclose's guidance

Liquidity Management

3.21 Combining changes to the regulatory environment and our adoption of a mainly three month lending limit, investments with financial institutions are now normally by means of purchasing 3 month Certificates of Deposit (CDs). Longer maturities can be obtained by depositing with the two Swedish banks, government bodies, with Central Government, via Treasury Bills up to 6 months, or locally. Attractive rates can be obtained from Local Authorities, though these will depend on being able to satisfy demand when it arises. At peak periods, mindful of the primacy of security as a criterion for decision making, substantial balances may be held in short term investments, particularly Money Market Funds. The use of short term borrowing at times of lower cash balances is judged to maintain a prudent balance between maintaining security and liquidity and achieving a reasonable yield on investments, though this was not required in 2015-16.

Yield

3.22 The UK Bank Rate was maintained at 0.5% through the year. Short term money market rates also remained at low levels which continued to have a significant impact on investment income. The average 3-month LIBID rate during 2015/16 was 0.53%, the 6-month LIBID rate averaged 0.73% and the 1-year LIBID rate averaged 1.03%. The low rates of return on the Council's short-dated money market investments reflect prevailing market conditions and the Council's objective of optimising returns commensurate with the principles of security and liquidity.

3.23 The Council's budgeted investment income for the year had been estimated at £0.7m. The average cash balance during the year 2015-16 was £186m and interest earned was £0.9m. The interest earned in 2014-15 was £0.9m on an average cash balance of £153m. Low rates of interest, as noted earlier, appear likely to continue in 2016/17. Indeed, it is quite likely that investment income will struggle to reach £0.9m in future years, if the Bank of England reduces rates.

Update on Investments with Icelandic Banks

3.24 The Council has now recovered 98% of its £10 million deposit with Heritable Bank. The administrators have not made any further estimate of final recoveries yet, though a further distribution is expected, subject to the outcome of a legal case.

Compliance

3.25 The Council confirms that it has complied with its Prudential Indicators for 2015/16, which were approved by the Council on 2 March 2014 as part of the Council's Treasury Management Strategy Statement.

3.26 In compliance with the requirements of the CIPFA Code of Practice this report provides members with a summary report of the treasury management activity during 2015/16. None of the Prudential Indicators have been breached and a prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield. Further information is set out in Appendix 2.

Investment Training

3.27 The needs of the Council's treasury management staff for training in investment management are kept under review and considered as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change.

3.28 During 2015/16 staff attended training courses, seminars and conferences provided by Arlingclose and CIPFA and opportunities which may arise with other organisations are considered.

3.29 A member training session on treasury management was held on 19 November 2015 which outlined the overall treasury management framework.

4. FINANCIAL IMPLICATIONS

4.1 Already noted within the report as this is the Treasury Management Outturn Report.

5. LEGAL IMPLICATIONS

5.1 There are no direct legal implications

6. DIVERSITY IMPLICATIONS

6.1 None identified.

7. STAFFING IMPLICATIONS

7.1 None identified.

8. BACKGROUND INFORMATION

Treasury Management Strategy Report to Council – 2 March 2016
2015/16 Mid-Year Treasury Report to Council – 8 September 2015

9. CONTACT OFFICERS

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Appendix 1 - Debt and Investment Portfolio Position 31/3/2016

	31/3/2016 Actual Portfolio £m	**31/3/2016 Average Rate %**
External Borrowing:		
PWLB – Maturity	288	5.0
PWLB – Equal Instalments of Premium	36	2.6
LOBO Loans	95	4.8
Total External Borrowing	**419**	**4.7**
Other Long Term Liabilities:		
PFI	32	9.5
Total Gross External Debt	**451**	**5.0**
Investments:		
Deposits	91	0.5
Marketable Instruments	50	0.6
Money Market Funds	23	0.4
Total Investments	**164**	**0.5**
Net Debt	**287**	**7.6**

Appendix 2 – Prudential Indicators

(a) Capital Financing Requirement (CFR)

The Council's cumulative maximum external borrowing requirement for 2015/16 is shown in the table below:

Capital Financing Requirement	31/03/2016 Estimate £m	31/03/2016 Actual* £m
General Fund	459	471
HRA	137	141
Total CFR	**596**	**612**

*Uses provisional estimates from Draft Statement of Accounts

Gross Debt and the Capital Financing Requirement: In order to ensure that over the medium term debt will only be for a capital purpose, the Council 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. This is a key indicator of prudence.

Debt	31/03/2016 Estimate £m	31/03/2016 Actual £m
Borrowing	419	419
PFI liabilities	33	32
Total Debt	**452**	**451**
Borrowing in excess of CFR?	**No**	**No**

(b) Authorised Limit and Operational Boundary for External Debt

The Operational Boundary for External Debt is based on the Council's estimate of most likely, i.e. prudent, but not worst case scenario for external debt. It links directly to the Council's estimates of capital expenditure, the capital financing requirement and cash flow requirements and is a key management tool for in-year monitoring.

Other long-term liabilities comprise finance lease, Private Finance Initiative and other liabilities that are not borrowing but form part of the Council's debt.

The Authorised Limit for External Debt is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Council can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

The Director of Finance confirms that there were no breaches to the Authorised Limit and the Operational Boundary during 2015/16.

	Operational Boundary (Approved) 31/03/2016	Authorised Limit (Approved) 31/03/2016	**Actual External Debt 31/03/2016**
Borrowing			419
Other Long-term Liabilities			32
Total	**680**	**780**	**451**

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

This indicator is set to control the Council's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of net principal borrowed.

	Approved Limits for 2015/16 Proportion %	Maximum during 2015/16 Proportion %
Upper Limit for Fixed Rate Exposure	100	100
Compliance with Limits:	Yes	Yes
Upper Limit for Variable Rate Exposure	40	0
Compliance with Limits:	Yes	Yes

(d) 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 at 31/03/2016 £m	% Fixed Rate Borrowing at 31/03/2016	Compliance with Set Limits?
under 12 months	40	0	29	7	Yes
12 months and within 24 months	20	0	34	8	Yes
24 months and within 5 years	20	0	60	14	Yes
5 years and within 10 years	60	0	10	2	Yes
10 years and within 20 years	100	0	25	6	Yes
20 years and within 30 years	100	0	1	0	Yes
30 years and within 40 years	100	0	154	37	Yes
40 years and within 50 years	100	0	106	26	Yes
50 years and above	100	0	0	0	Yes

(e) 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	31/03/2016 Estimate £m	31/03/2016 Actual £m
Non-HRA	68	60
HRA	34	33
Total	**102**	**93**

(f) 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, net of investment income.

Ratio of Financing Costs to Net Revenue Stream	31/03/2016 Estimate %	31/03/2016 Actual %
Non-HRA	10.49	8.08
HRA*	12.35	12.50
Total	10.60	8.64

(g) Adoption of the CIPFA Treasury Management Code

This indicator demonstrates that the Council adopted the principles of best practice.

The Council adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition* in February 2013

(h) Upper Limit for Total Principal Sums Invested Over 364 Days

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

	31/03/2016 Approved £m	31/03/2016 Actual £m
	20	0

(i) HRA Limit on Indebtedness

HRA Debt Cap (as prescribed by CLG)	£199m	
	31/03/2016 Estimate £m	31/03/2016 Actual £m
HRA CFR	137	141*

*Provisional Based on Draft Accounts