

**Report of Chief Officer Deputy Chief Executive**

**Report to Corporate Governance and Audit Committee**

**Date: 27<sup>th</sup> January 2017**

**Subject: Treasury Management Governance Report 2016**

Are specific electoral Wards affected? If relevant, name(s) of Ward(s):	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No
Are there implications for equality and diversity and cohesion and integration?	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No
Is the decision eligible for Call-In?	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No
Does the report contain confidential or exempt information? If relevant, Access to Information Procedure Rule number: Appendix number:	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No

**Summary of main issues**

1. This annual report provides assurance that the Treasury Management (TM) function is operating within its governance framework.
2. TM fully complies with the current CIPFA Code of Practice, the Prudential Code and the revised guidance notes for practitioners issued in 2013.
3. Since the last update all borrowings and investments undertaken have been in accordance with the approved governance framework.
4. TM operates within the governance framework and also uses additional market intelligence and information gathered from a variety of sources. These sources have been integral to protecting the authority from undue risk in the financial and money markets.
5. Internal Audit has provided substantial assurance on the control environment and compliance in their 2015/16 audit report.

**Recommendations**

6. Note that Treasury Management continues to adhere to its governance framework including the CIPFA Code of Practice, the Prudential Code and revised CIPFA guidance notes issued in 2013. All borrowing and investments undertaken have been compliant with the governance framework.

## **1. Purpose of this report**

- 1.1 This annual report outlines the governance framework for the management of the Council's TM function. This report also reviews compliance with updated CIPFA guidance notes for practitioners on the Prudential Code for Capital Finance in Local Authorities issued in 2011.

## **2 Background information**

- 2.1 The operation of the TM function is governed by provisions set out under part 1 of the Local Government Act 2003 whereby the Council is required to have regard to the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code for Capital Finance in Local Authorities 2011 in particular: The Prudential Code requires that full Council set certain limits on the level and type of borrowing before the start of the financial year together with a number of Prudential indicators.

- Any in year revision of these limits must be set by Council.
- Policy statements are prepared for approval by the Council at least two times a year.

- 2.2 TM is responsible for managing the Housing Revenue Account and General Fund long term debt which is in the region of £1.82bn and investments that currently stand at around £48m. It also manages the cash flow requirements of the Council.

## **3 Main issues**

- 3.1 The role of the Corporate Governance and Audit Committee is to ensure that TM is adhering to and operating within its governance framework, as shown in Appendix A.
- 3.2 During the year TM has continued to comply with the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management, Prudential Code (2011) and its guidance notes (2013). As such a strategy report was presented to Executive Board in February 2016 together with an update in November 2016. A further outturn report for the previous financial year was presented in June 2017.
- 3.3 During the year all borrowings and investments undertaken have been in accordance with the approved governance framework and are in line with the Treasury Management Policies and Practices.
- 3.4 In recent years the treasury strategy has taken advantage of the low short-term interest rates to fund its long term borrowing requirement. The Council's balance sheet strength has also been used to defray long term borrowing and avoid the risk associated with external investments. Whilst the Council's balance sheet remains strong there has been a greater use of cash balances since the strategy was written in February 2016. The Council's capital programme borrowing requirement has also increased to reflect the purchase of strategic assets. These investments are part of the Council's medium term financial strategy in providing greater revenue resilience.
- 3.5 The result of the above factors has resulted in the need to increase the Council's borrowing limits. Full Council agreed to the increase in the Prudential Borrowing Indicator limits for both the Operational Boundary by £180m and the Authorised limit by £200m in November 2016 as part of the 6 monthly treasury update.

- 3.6 The 2016 November Executive Board update report highlighted that the current borrowing strategy continues to fund the borrowing requirement of the capital programme from short dated loans and internal cash balances. There will come a point when rates begin to rise and more expensive longer dated funding will be required, even though this continues to be pushed further back as the economic outlook evolves. The strategy of deferring long term borrowing will increase the amount of debt that the Council is funding from short term loans and its balance sheet to a forecast £584m. This exposure is considered manageable given historical capital programme slippage, the strength of the Council's balance sheet and the market for supplying short term funds remaining strong. These factors will continue to be monitored and should be considered in the context of the stability of the current debt maturity profile.
- 3.7 The Council's current long term debt of £1.476bn has an average maturity of just over 38 years if all debts run to maturity. Approximately 30% of the Council's debt has options for repayment, in the unlikely event that all these options were exercised at the next option date then the average maturity of long term debt would be lowered to just over 23 years. This compares favourably with the average maturity of the UK's government debt portfolio which remains at nearly 14 years. The existing profile of the Council's debt provides considerable certainty of funding costs with 55% or £818m of its debt maturing in periods greater than 10 years.
- 3.8 The Lenders Option Borrowers Option loans (LOBO's) that many Local Authorities issued up to 2007/08 have been reported negatively in the national news and on TV during 2016. These have been used successfully over the last 20 years to reduce the Councils interest costs in comparison to Public Works Loan Board (PWLb) funding available at the time. These loans also introduced short to medium term re-financing risk at a time when the average maturity of the Councils debt portfolio was becoming very long. In essence the standard LOBO's that the Council has issued are long dated loans, which after an initial fixed period, contain an option whereby the lender only can vary the rate of interest on the loan, but only at specific intervals. These periods are every 3, 5 or 6 years depending on the specific loan. If the lender exercises the option the Council then has the option to accept the change or to repay the loan without any penalty cost and repay the principal in full. No options have been exercised since 2008 and in the current economic climate these loans are essentially fixed.
- 3.9 The Council's total Capital Financing Requirement CFR i.e. the amount required to fund previous and current capital expenditure is circa £2bn and its assets are valued at over £4bn. The setting and monitoring of the capital programme seeks to ensure that we invest and maintain our assets and that it supports the best Council priorities of the Council. Treasury Management strategy determines the revenue affordability of the programme.
- 3.10 To mitigate against the exposure to rising interest rates the Council continues to explore forward funding options which will give the Council the ability to lock in future funding at current rates.
- 3.11 TM continues to review key aspects of the framework including prudential indicators to ensure that they continue to be fit for purpose and provide the right evidence that TM is operating within acceptable levels of risk. The strategy updates to Executive Board include an update on prudential indicators. TM is complying with all of CIPFA's prudential indicators as shown at Appendix B which was reported to Executive Board on 16<sup>th</sup> November 2016.

- 3.12 The operation of TM within its governance framework is also complemented by additional market intelligence and information gathered from a variety of sources. These tools involve:
- The use of real time market information on the financial and money markets in the UK, Europe, US and other major economies;
  - Discussions with market participants and brokers;
  - Use of treasury advisors to test market views;
  - Networking and sharing of information with Core Cities and West Yorkshire districts;
  - Attending market seminars providing technical and economic updates;
  - Daily market updates from financial institutions and brokers;
  - Thorough review of new financial products and how they fit within the governance structure; and
  - Undertaking continuing professional development and ensuring that appropriate training is undertaken.
- 3.13 Furthermore TM undertakes to respond to all treasury management consultations and influence the national governance framework, through attendance at regular core city meetings.
- 3.14 Internal Audit has completed its annual review of the TM function. This involved a risk based system audit of TM to evaluate and validate key systems controls. Two separate but linked reports were issued :-

#### **Treasury Management & Bankline 2015/16**

Key controls for a sample of investments, loans and interest payments for 2015/16 were reviewed. The Internal Audit report issued 20<sup>th</sup> May 2016 provided two opinions:

- Control Environment - Substantial Assurance (highest level). This provides assurances that there are minimal control weaknesses that present very low risk to the control environment.
- Compliance with the Control Environment - Substantial Assurance (highest level). This level indicates that the control environment has substantially operated as intended although some minor errors have been detected in the sample tested.

#### **Bankline & LATIMA Systems Audit 2015/16**

The purpose of the review was to provide assurance that appropriate controls are in place to ensure access to systems is appropriately controlled, data input is complete and accurate, data is correctly processed and the required outputs produced, systems include an audit trail and appropriate business continuity arrangements are in place. The Internal Audit report issued 20<sup>th</sup> May 2016 provided one opinion:

- Controls - Substantial Assurance (highest level). This provides assurances that there are minimal control weaknesses that present very low risk to the control environment.

- 3.15 The outcome of the 2016/17 internal audit will be reported as part of the Financial Planning and Management Arrangements 2017 report expected to be made to Committee in July 2017.

## **4 Corporate Considerations**

### **4.1 Consultation and Engagement**

4.1.1 There has been no consultation in relation to this report

### **4.2 Equality and Diversity / Cohesion and Integration**

4.2.1 This report does not have any direct equality and diversity/cohesion and integration issues.

### **4.3 Council policies and Best Council Plan**

4.3.1 The execution of the Treasury Management strategy secures funding to support the Council's Policies and City Priorities as set out in the Council capital programme and is consistent with the Best Council Plan.

### **4.4 Resources and value for money**

4.4.1 The execution of the Treasury Strategy enables funds to be raised and managed in the most efficient manner in line with the approved strategy as presented to Executive Board on 10<sup>th</sup> February 2016.

### **4.5 Legal Implications, Access to Information and Call In**

4.5.1 The legislative framework which governs TM is outlined in section 2.1. This framework includes compliance with the CIPFA Treasury Management Code of Practice, the prudential code 2011 and revised guidance notes issued in 2013.

4.5.2 There are no legal or access to information issues arising from this report.

### **4.6 Risk Management**

4.6.1 As set out in the Treasury Management Policy Statement, TM activities are carried out within a risk management framework and the management of risk is key to securing and managing the Council's borrowing, lending and cash flow activities.

4.6.2 By complying with and adopting the CIPFA Treasury Management Code of Practice, Prudential Code and guidance notes, assurance is given that arrangements are in place to manage risks effectively.

## **5 Conclusions**

5.1 This report confirms that the Council is operating within its governance framework and as such is complying with the CIPFA Treasury Management Code of Practice, Prudential Code and updated guidance notes. A 2015/16 Internal Audit report gave TM substantial assurance on both control and compliance and a second 2015/16 Internal Audit report on critical business systems used in the provision of the Treasury Management operation gave substantial assurance on the controls within those systems.

## **6 Recommendations**

6.1 Note that Treasury Management continues to adhere to its governance framework including the CIPFA Code of Practice, the Prudential Code and revised CIPFA guidance notes issued in 2013. All borrowing and investments undertaken have been compliant with the governance framework.

## **7 Background documents<sup>1</sup>**

7.1 None

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<sup>1</sup> The background documents listed in this section are available to download from the Council's website, unless they contain confidential or exempt information. The list of background documents does not include published works.

## Treasury Management Governance Framework

FULL COUNCIL	EXECUTIVE BOARD	CORPORATE GOVERNANCE & AUDIT COMMITTEE	RESOURCES AND COUNCIL SERVICES SCRUTINY BOARD
Setting Borrowing limits	Treasury Management Strategy	Adequacy of Treasury Management policies and practices	Review / scrutinise any aspects of the Treasury management function
Changes to borrowing limits	Monitoring reports in year	Compliance with statutory guidance	
Treasury Management Policy	Performance of the treasury function		
↓ DELEGATIONS TO OFFICERS			
DELEGATION SCHEME	TO WHOM	FUNCTION DELEGATED	
Officer delegation scheme (Executive Functions)	Deputy Chief Executive	Making arrangements for the proper administration of the authority's financial affairs	
Directors delegation under Articles, Specific delegations of the Deputy Chief Executive 12.4 Page 10	Discharged through Chief Officer Financial Services	Making arrangements for the proper administration of the authority's financial affairs (includes S151 responsibilities as his deputy)	
Executive Functions Specific Delegations Page 24 (d) Treasury Management	To Chief Officer Financial Services	The provision of financial services, including treasury management (encompassing the making of payments and borrowing of loans)	
Miscellaneous Functions - Financial Regulation 20: Treasury Management Page 32	Function delegated to Chief Officer (Financial Services) with the power to sub delegate to the Chief Officer (Audit and Investments)	To ensure that all investment and borrowing is valid, accurate, efficient, properly accounted for and in accordance with statutory and corporate requirements	

**↓ OPERATIONAL AUTHORITY OF OFFICERS/CONTROL FRAMEWORK**

<b>POLICY DOCUMENT</b>	<b>TO WHOM</b>	<b>OPERATIONAL AUTHORITY</b>
Treasury Management Policy Statement (section 11) Policy on Delegation and Review Requirements and Reporting Arrangements	Chief Off. Financial Services Chief Off. Audit & Investment Principal Financial Manager Senior Treasury Manager Assistant Finance Manager	Implementation of decisions taken at Treasury strategy review meetings and day to day management of treasury operations
CIPFA: Code of Practice Prudential Code Guidance Notes	Principal Financial Manager Senior Treasury Manager Assistant Finance Manager	Ensure compliance and that any changes are reflected in the operating framework.



## Leeds City Council - Prudential Indicators 2016/17 - 2018/19

No.	PRUDENTIAL INDICATOR	2016/17	2017/18	2018/19
	<b>(1). EXTRACT FROM BUDGET AND RENT SETTING REPORTS</b>			
1	<b>Ratio of Financing Costs to Net Revenue Stream</b> General Fund - Excluding DSG (Note1)	13.68%	16.68%	18.07%
2	HRA	10.58%	11.35%	11.44%
3	<b>Impact of Unsupported Borrowing on Council Tax &amp; Housing Rents</b> increase in council tax B7(band D, per annum) (Note 2)	£ . P 16.31	£ . P 58.00	£ . P 89.51
4	increase in housing rent per week	0.03	0.33	0.69
5	Net Borrowing and the capital financing requirement (Note 3)	OK	OK	OK
6	<b>Estimate of total capital expenditure</b> Non HRA	302,237	237,217	141,962
7	HRA	139,269	129,693	96,036
	TOTAL	441,506	366,910	237,998
8	<b>Capital Financing Requirement (as at 31 March)</b> Non HRA	£'000 1,846,732	£'000 1,923,885	£'000 1,944,362
9	HRA	825,380	849,412	843,538
	TOTAL	2,672,112	2,773,297	2,787,900
9a	Limit of HRA Indebtedness as implemented under self financing	725,327	725,327	725,327

No.	PRUDENTIAL INDICATOR	2016/17	2017/18	2018/19
	<b>(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS</b>	£'000	£'000	£'000
10	<b>Authorised limit for external debt - (Note 5)</b> borrowing other long term liabilities TOTAL	2,100,000 760,000 2,860,000	2,100,000 740,000 2,840,000	2,100,000 720,000 2,820,000
11	<b>Operational boundary - (Note 5)</b> borrowing other long term liabilities TOTAL	1,930,000 740,000 2,670,000	1,970,000 720,000 2,690,000	2,010,000 700,000 2,710,000
14	<b>Upper limit for fixed interest rate exposure</b> expressed as either:- Net principal re fixed rate borrowing / investments OR:- Net interest re fixed rate borrowing / investments	115%	115%	115%
15	<b>Upper limit for variable rate exposure</b> expressed as either:- Net principal re variable rate borrowing / investments OR:- Net interest re variable rate borrowing / investments	40%	40%	40%
17	<b>Upper limit for total principal sums invested for over 364 days (Note 5)</b> (per maturity date)	150,000	150,000	150,000
18	<b>Net Debt as a percentage of Gross debt</b>	98.5%	99.6%	99.6%

16	Maturity structure of fixed rate borrowing as at 31/03/2016	Lower Limit	Cumulative Upper Limit	Projected 31/03/2017
	under 12 months	0%	15%	0.00%
	12 months and within 24 months	0%	20%	13.56%
	24 months and within 5 years	0%	35%	19.24%
	5 years and within 10 years	0%	40%	9.24%
	10 years and within 20 years			1.77%
	20 years and within 30 years			0.00%
	30 years and within 40 years	25%	90%	34.13%
	40 years and within 50 years			22.07%
	50 years and above			0.00%
				100%

otes.

- The indicator for the ratio of financing costs to net revenue stream for General Fund is now calculated based on the Net Revenue Charge less the Dedicated Schools Grant (DSG). The Government changed the funding of education to DSG from 2006/07.
- The code requires that the Council identifies the capital financing costs arising from unsupported borrowing expressed as the amount per band D property.
- In order to ensure that over the medium term net borrowing will only be for a capital purpose, the Council should ensure that net external borrowing does not exceed the total capital financing requirement in the preceding year plus estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence.
- Prudential indicator 12 relates to actual external debt at 31st March, which will be reported in the Treasury Management Annual Report.
- Prudential indicator 13 relates to the adoption of the CIPFA Code of Practice on Treasury Management. The Council formally adopted this Code of Practice in March 2003, and the revised code in February 2010 and 2012

