Leeds CITY COUNCIL

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Report of Deputy Chief Executive

Report to Executive Board

Date: 18th November 2015

Subject: TREASURY MANAGEMENT STRATEGY UPDATE 2015/16

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

Summary of main issues

1. This report provides a review and update of the treasury management strategy for 2015/16

2. The Council's level of external debt as at 31st March 2016 is anticipated to be £1,475m, £16m higher than approved in February 2015. This higher forecast borrowing requirement is due to a combination of capital programme scheme adjustments and improved revenue balances. The level of debt is expected to remain within the Authorised Limit for external debt as agreed by Council on 14th February 2015.

3. Monitoring of money and financial markets has resulted in forecast revenue savings of £0.2m excluding MRP asset life review. This saving is largely due to continuing to fund the borrowing requirement from short term loans at historic low rates and internal cash balances.

4. The investment of surplus monies will continue to have due regard for security of capital in accordance with the Council's approved investment strategy.

Recommendations

That Executive Board:-

1. Note the update on the Treasury Management borrowing and investment strategy for 2015/16.

2. Note the changes to investment criteria methodology as outlined in 3.4.

1 Purpose of this report

1.1 The 2015/16 treasury management strategy was approved by Executive Board on 11th February 2015. This report provides a review and update of the strategy for 2015/16.

2 Background information

2.1 The operation of the Treasury Management 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 (amended 2009 and 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 three times a year.

3 Main issues

3.1 *Review of Strategy 2015/16*

3.1.1 The current borrowing forecasts are shown in Table 1

Table 1

ANALYSIS OF BORROWING 2013/2014		2015/16 Feb 15 Report £m	2015/16 This Report £m
Net Borrowing at 1 April		1,419	**1,406**
New Borrowing for the Capital Programme – Non HRA		102	**131**
New Borrowing for the Capital Programme – HRA		0	**0**
Debt redemption costs charged to Revenue (Incl HRA)		(48)	**(48)**
Reduced/(Increased) level of Revenue Balances		(14)	**(14)**
Net Borrowing at 31 March*		1,459	**1,475**
Capital Financing Requirement			**1,890**
* Comprised as follows			
Long term borrowing	Fixed	1,262	**1,358**
	Variable (less than 1 Year)	110	**0**
	New Borrowing	40	**69**
Short term Borrowing		57	**54**
Total External Borrowing		1,469	**1,481**
Less Investments		10	**6**
Net External Borrowing		1,459	**1,475**
% borrowing funded by short term and variable rate loans		14%	**8%**

Note: The Capital Financing Requirement (CFR) is the maximum level of debt (i.e. borrowing PFI and finance leasing) that the Council can hold for its current year capital purposes. The Council is also allowed to borrow in advance for up to two future years capital programmes. The above reflects only the borrowing element of the CFR

3.1.2 Table 1 above shows that 2015/16 net external borrowing is now forecast at £1,475m, £16m higher than in the report to Executive Board on 11th February 2015**.** This higher forecast borrowing requirement is as a result of a number of capital schemes (£7m) being slipped and bringing forward the full operational date of the £30m energy from waste scheme from 2016/17 into 2015/16. There was also a £7m improvement in revenue balances. The review of and update of the capital programme is considered in the half year update on the capital programme elsewhere on the agenda.

3.1.3 The UK has seen growth rates of 2.20% in 2013 and 2.9% in 2014 which were amongst the strongest in the G7 group of nations. With Q1 growth slowing to 0.4% and Q2 picking up to 0.7% the Bank of England estimates growth for 2015 to be in the region 2.40% to 2.80% and remain at these levels over the next 3 years. Recent market surveys have however pointed to headwinds centred on factors such as the slowdown in the EU, China, Japan, and emerging markets. These headwinds are going to make the rebalancing of the UK economy away from the consumer and towards exports a more difficult prospect.

3.1.4 Unemployment continued to fall into 2015 but currently stands at 5.4%. The region's youth unemployment whilst falling is still in the region is 16.4%. CPI Inflation for September posted a fall to -0.1% and the inflation forecast remains subdued over the 2 year time horizon. The fall in oil prices to around $50 per barrel is largely due to oversupply and reduced demand from China. It is significant that with Inflation at around 0% and wage growth at 2.90% household disposal income is increasing after several years of reducing income.

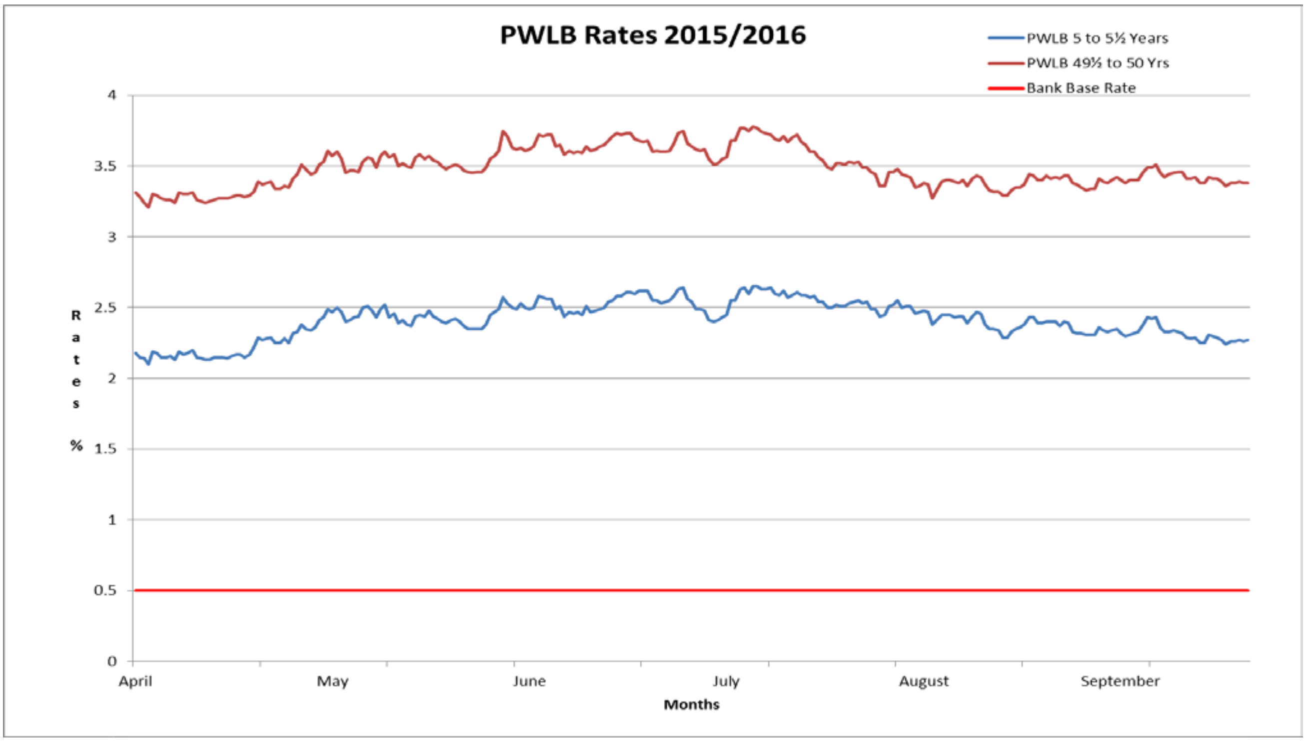
3.1.5 In the US the Federal Reserve, after considering raising rates in September, has now pulled back due to the recent global slowdown. Most commentators now expect the first rise in Q1 2016. US growth continues to be strong with the Q2 figure showing an annualised growth rate of 3.9%. China has been very active with stimulus measures in 2015 in an effort to achieve its stated 7% growth target however concerns exist as to the creditworthiness of bank lending to corporates and local government since 2008. A hard landing remains a prospect for China and confidence is fragile.

3.1.6 The Eurozone has again put off the Greece issue after eventually reaching agreement on a third bailout package of Euro 86bn. Significant doubts remain as to whether the reforms agreed as part of the bailout package will, if implemented, resolve the issue of Greek debt. In January 2015 a Euro 1.1 Trillion Quantitive Easing (QE) programme was announced. This was implemented in March 2015 at Euro 60bn per month and is expected to run until September 2016. In response, growth across the block appears to be responding - reaching 1.5% year on year in Q2.

3.1.7 There are considerable risks around whether inflation will rise in the near future. Oil shows no sign of rebounding significantly. The slowdown in China and emerging markets is reducing the demand for oil and other commodities. Inflation is expected to only slowly increase and therefore in both the UK and the US the timing of the first increase in base rate is being pushed further into the future. It is suggested by some commentators that the effect of rate increases will be significant on heavily indebted consumers and this factor may therefore limit the pace of subsequent increases. Current expectation of the first rate increase is Q1 2016 in the US and Q2 2016 for the UK although these are not guaranteed and may be subject to change due to prevailing UK and international factors.

3.1.8 Chart 1, shows how the cost of longer term borrowing from the Government through PWLB loans has performed since the start of the financial year. The 5 year to 5½ Year PWLB has moved upwards from a low point in April of 2.10% to a high of 2.63% in July before falling back to the current low of 2.27%. Similarly, the 49½-50 year PWLB has moved from a low in April of 3.21% to a high of 3.78% in July and back to 3.38% now. The Council is entitled to a reduction of 20bp on all PWLB rates reflecting eligibility for PWLB certainty rates.

Chart 1



3.1.9 Given the outlook for domestic and international economic growth, the prospects for any interest rate changes before mid-2016 are limited. There is potential for the start of Bank Rate increases to be even further delayed if growth continues to be subdued and inflation factors do not materialise. The latest forecast of rates is shown in the following table.

Table 2

	Now	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18
BANK RATE	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.25	1.50	1.50	1.75	1.75
3 month LIBID	0.46	0.60	0.70	0.80	0.90	1.10	1.30	1.40	1.50	1.80	1.90	1.90
6 month LIBID	0.63	0.80	0.90	1.00	1.10	1.30	1.50	1.60	1.70	2.00	2.10	2.10
12 month LIBID	0.94	1.10	1.20	1.30	1.40	1.60	1.80	1.90	2.00	2.30	2.40	2.40
5 yr PWLB	2.19	2.40	2.50	2.60	2.80	2.90	3.00	3.10	3.20	3.30	3.40	3.50
10 yr PWLB	2.77	3.00	3.20	3.30	3.40	3.50	3.70	3.80	3.90	4.00	4.10	4.20
25 yr PWLB	3.31	3.60	3.80	3.90	4.00	4.10	4.20	4.30	4.40	4.50	4.60	4.60
50 yr PWLB	3.17	3.60	3.80	3.90	4.00	4.10	4.20	4.30	4.40	4.50	4.60	4.60

3.1.10 Expectations for the first change in Bank Rate in the UK have slowly been pushed back during the year as the wider economic picture has emerged and the first increase is now not expected until Q2 2016. As a result the following table shows the revised forecast interest funding assumptions

Table3

Budget Rate Assumptions	2015/16	2016/17	2017/18	2018/19	2019/20
Exec Board Feb 15	0.65	1.75	2.25	3.50*	3.50*
Now	0.50	0.75	1.35	2.50	3.50*

* provisional assumption

3.1.11 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. No new long term loans have been acquired during 2015/16 so far. The Deputy Chief Executive will continue to monitor market dynamics with a view to securing longer term debt at the appropriate time.

3.1.12 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 £532m. This exposure is considered manageable given historical capital programme slippage, the continued 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.

3.1.13 To mitigate against the exposure to rising interest rates the Council is exploring a number of forward funding options which will give the Council the ability to lock in future funding at current rates.

3.1.14 The Council's current long term debt of £1.367bn has an average maturity of just over 38 years if all debts run to maturity. Approximately 33% 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 21½ years. This compares favourably with the average maturity of the UK's government debt portfolio which remains just above 14 years and the US where the average is just under 6 years (source FT 20/10/2015). The existing profile of the Council's debt provides considerable certainty of funding costs. Prudential Indicator 16 in Appendix A shows the maturity profile of the Council's long term fixed debt and highlights that 55.3% or £707m matures in periods greater than 10 years.

3.1.15 Short term debt at low rates of interest and existing revenue balances continue to be used to fund the borrowing requirement which has resulted in forecast savings of £0.2m. This excludes any further savings from MRP that may accrue from the review of as assets lives which is currently ongoing.

3.2 Borrowing Limits for 2015/16, 2016/17 and 2017/18

3.2.1 The Council is required to set various limits for 2015/16, 2016/17 and 2017/18 in accordance with the Local Government Act 2003, having regard for CIPFA's prudential code (as amended 2009 and 2011). These limits including prudential indicators are detailed in Appendix A.

3.2.2 Borrowing limits for 2015/16 were approved by Council on 11th February 2015 and remain unchanged.

3.2.3 It is anticipated that the authority will continue to remain within the Authorised Limits for 2015/16. Both the Authorised Limit and Operational Boundary are made up of a limit for borrowing and a limit for other long term liabilities. The Deputy Chief Executive has authority, under the Prudential Code, to vary these two elements within the overall limits. Current performance against borrowing limits is shown in Appendix B.

3.3 Investment Strategy & Limits

3.3.1 The Council's external debt is reduced by the availability of revenue balances. The Treasury policy also allows for the external investment of these balances at advantageous rates but with due regard for security of capital invested. At present the Council's surplus monies continue to be held in short periods until required. As market sentiment to counter-party risk improves, together with enhanced returns - surplus monies will be invested in accordance with the approved lending list. This lending list is based upon the assessment of the financial standing of counterparties as determined by international credit rating agencies and further refined and updated by the Council's advisors on a continual basis. The lending list is often further restricted based upon the Council's view of the credit worthiness of counter-parties.

3.3.2 The investment strategy, as re-affirmed by Executive Board and full Council in February, allows for the Council to invest in only the most highly rated financial institutions around the world. The Council will only lend up to a maximum of £15m to financial institutions that are rated as excellent. There is also a limit of £5m for financial institutions that are rated as very good.

3.4 Change to Credit rating agencies Methodology

3.4.1 The Council uses a counterparty investment list, supplied by the Council's Treasury Advisors, before consideration is given to placing an investment. This list is based upon the main rating agencies financial assessment of the counterparty. Changes have been made to the methodology to reflect that as Government support is withdrawn the banks have a greater capital buffer to cope with financial stresses in the economy. In summary the change in methodology has not significantly impacted on the ratings of the counterparty.

3.4.2 Prior to 2008 the main rating agencies applied an uplift on various institutions due to implied levels on sovereign support. During 2015 these have begun to be steadily removed as the evolving regulatory regime of "bail-in" has taken hold. In many cases, the balance sheets of banks are now much more robust than they were before the 2008 financial crisis when they had higher ratings than now.

3.4.3 These changes have led to certain elements of rating being either withdrawn (Moody's Financial Strength rating) or significantly downgraded (Fitch's Support and Viability ratings) It is important to stress that the other key elements to this process, namely the assessment of Rating Watch and Outlook information as well as the Credit Default Swap (CDS) overlay have not been changed.

3.4.4 These rating agency changes do not reflect any changes in the underlying status or credit quality of the institution, merely a reassessment of their methodologies in light of the regulatory environment in which financial institutions operate. Some banks are rated modestly higher whilst some are rated modestly lower.

3.4.5 Over and above this methodology for evaluating the credit worthiness of counterparties, which is performed by the Council Treasury Advisors, the Council continues to apply its own in-house view as to the desirability of any potential counterparty, before an investment is made.

4 Corporate Considerations

4.1 Consultation and Engagement

4.1.1 This report is an update on strategy as presented to Executive Board in February 2015, as such no consultation has taken place. However, consultation with the Council's treasury advisors takes place regularly throughout the year.

4.1.2 The borrowing requirement is an outcome of the capital programme. Consultation is undertaken by individual services in relation to capital investment schemes. A capital programme update report is included elsewhere on this agenda.

4.2 Equality and Diversity / Cohesion and Integration

4.2.1 Equality, diversity, cohesion and integration requirements are addressed as part of individual capital scheme and programme approvals. The borrowing to deliver these capital schemes is executed through treasury strategy and as such there are no further equality diversity cohesion and integration issues.

4.3 Council policies and Best Council Plan

4.3.1 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 This update on the treasury strategy recognises the borrowing necessary to fund the capital programme requirements of both General Fund and HRA. Where borrowing is supported the revenue costs are met by the Government, whilst for unsupported borrowing revenue costs are met either by the General Fund or HRA.

4.4.2 The updated strategy 2015/16 is forecast to deliver savings of £0.2m against the budgeted position.

4.5 Legal Implications, Access to Information and Call In

4.5.1 There are no legal, or access to information issues arising from this report. The report is subject to call in.

4.6 Risk Management

4.6.1 This report sets out the framework for the treasury strategy for the year ahead. The execution of strategy and associated risks are kept under regular review through:

- Monthly reports to the Finance Performance Group
- Quarterly strategy meeting with the Deputy Chief Executive and the Council's treasury advisors
- Regular market, economic and financial instrument updates and access to real time market information
- Treasury management meetings with the Core Cities and West Yorkshire Districts.

5 Conclusions

5.1 The Council's level of external debt at 31st March 2016 is anticipated to be £1,475m, £16m higher than expectations in February 2015.

5.2 Treasury Management activity has enabled revenue savings of £0.2m. This is largely due to funding the Council's borrowing requirement from short-term loans at historic low rates and use of internal cash balances, in lieu of more expensive longer term funding at much higher rates.

5.3 It is anticipated that the authority will remain within the approved limits for 2015/16 as outlined in paragraph 3.2.3.

5.4 The Council's Advisors have amended the methodology used to compile the investment counterparty list. These changes reflect updated rating agencies methodology in response to the continued removal of Government support, as the banks have greater capital buffers to cope with financial stresses in the economy. In summary the change in methodology has not significantly impacted on the rating of the counterparty.

6 Recommendations

That Executive Board:-

6.1 Note the update on the Treasury Management borrowing and investment strategy for 2015/16.

6.2 Note the changes to investment criteria methodology as outlined in 3.4.

7 Background documents[1]

None

[1] 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

Appendix A

Leeds City Council - Prudential Indicators 2015/16 - 2017/18

No.	PRUDENTIAL INDICATOR	2015/16	2016/17	2017/18
	(1). EXTRACT FROM BUDGET AND RENT SETTING REPORTS			
	Ratio of Financing Costs to Net Revenue Stream			
1	General Fund - Excluding DSG (Note1)	12.81%	13.80%	14.87%
2	HRA	11.88%	11.80%	12.70%
	Impact of Unsupported Borrowing on Council Tax & Housing Rents	**£ . P**	**£ . P**	**£ . P**
3	increase in council tax B7(band D, per annum) (Note 2)	13.77	54.47	87.56
4	increase in housing rent per week	0.00	5.73	24.88
5	Net Borrowing and the capital financing requirement (Note 3)	OK	OK	OK
	Estimate of total capital expenditure			
6	Non HRA	261,047	222,125	173,974
7	HRA	97,728	124,958	116,202
	TOTAL	358,775	347,083	290,176
	Capital Financing Requirement (as at 31 March)	**£'000**	**£'000**	**£'000**
8	Non HRA	1,781,333	1,824,694	1,855,392
9	HRA	820,260	833,779	843,492
	TOTAL	2,601,593	2,658,473	2,698,884
9a	**Limit of HRA Indebtedness as implemented under self financing**	725,327	725,327	725,327

No.	PRUDENTIAL INDICATOR	2015/16	2016/17	2017/18
	(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	**£'000**	**£'000**	**£'000**
10	**Authorised limit for external debt - (Note 5)**			
	borrowing	1,800,000	1,800,000	1,800,000
	other long term liabilities	780,000	760,000	740,000
	TOTAL	2,580,000	2,560,000	2,540,000
11	**Operational boundary - (Note 5)**			
	borrowing	1,600,000	1,650,000	1,750,000
	other long term liabilities	760,000	740,000	720,000
	TOTAL	2,360,000	2,390,000	2,470,000
14	**Upper limit for fixed interest rate exposure**			
	expressed as either:-			
	Net principal re fixed rate borrowing / investments OR:-	115%	115%	115%
	Net interest re fixed rate borrowing / investments			
15	**Upper limit for variable rate exposure**			
	expressed as either:-			
	Net principal re variable rate borrowing / investments OR:-	40%	40%	40%
	Net interest re variable rate borrowing / investments			
17	**Upper limit for total principal sums invested for over 364 days (Note 5**	150,000	150,000	150,000
	(per maturity date)			
18	**Net Debt as a percentage of Gross debt**	99.6%	99.6%	99.6%

16	**Maturity structure of fixed rate borrowing as at 31/03/2015**	**Lower Limit**	**Cumulative Upper Limit**	**Projected 31/03/2016**
	under 12 months	0%	15%	1.86%
	12 months and within 24 months	0%	20%	4.30%
	24 months and within 5 years	0%	35%	27.90%
	5 years and within 10 years	0%	40%	10.60%
	10 years and within 20 years			3.43%
	20 years and within 30 years			0.00%
	30 years and within 40 years	25%	90%	28.67%
	40 years and within 50 years			23.24%
	50 years and above			0.00%
				100%

otes.

1 **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.**

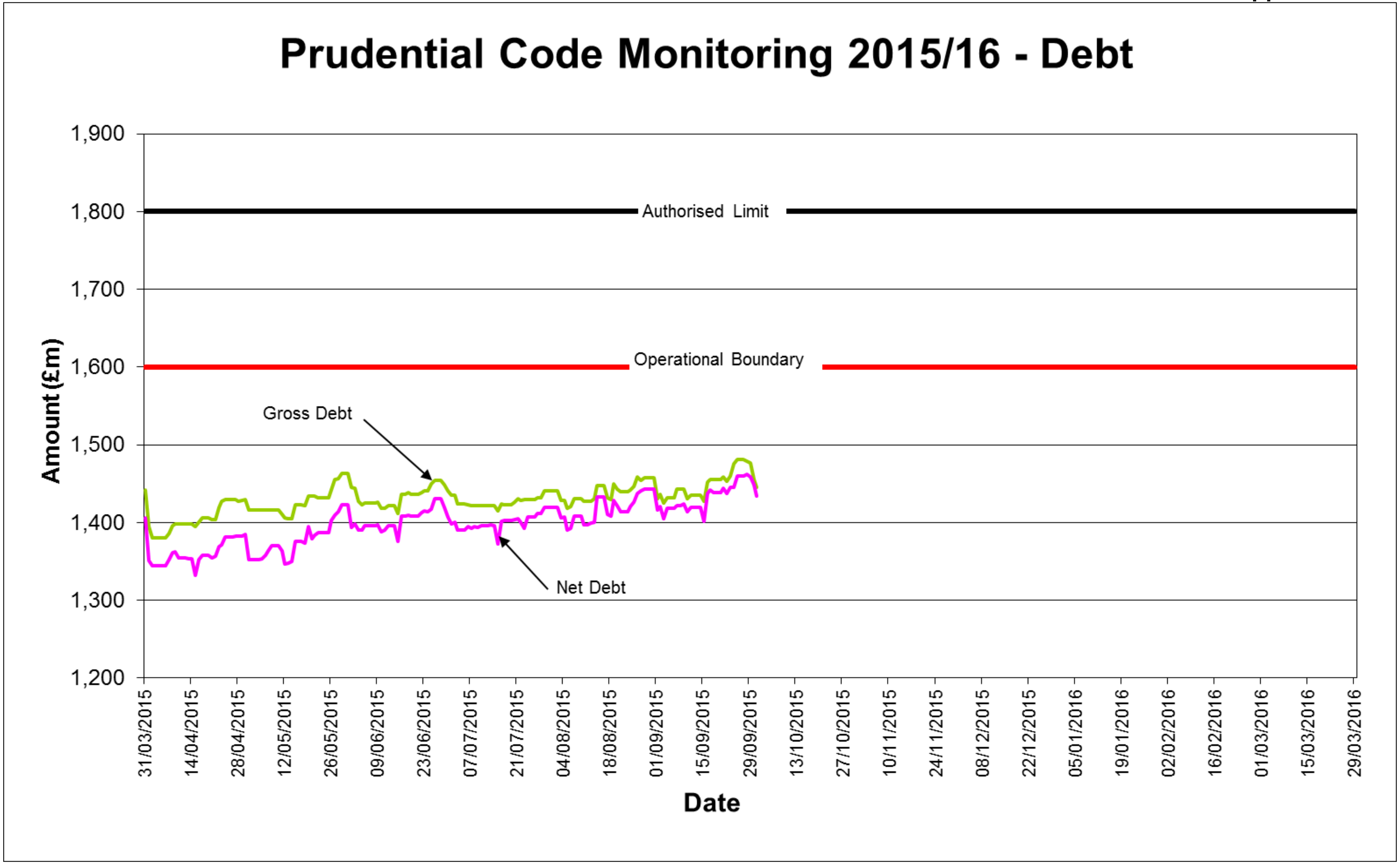
2 **The code requires that the Council identifies the capital financing costs arising from unsupported borrowing expressed as the amount per band D property.**

3 **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.**

4 **Prudential indicator 12 relates to actual external debt at 31st March, which will be reported in the Treasury Management Annual Report.**

5 **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 Frebruary 2010 and 2012**

Appendix B



Prudential Code Monitoring 2015/16 - Debt
1,900
1,800
1,700
1,600
1,500
1,400
1,300
1,200
Amount (£m)
Authorised Limit
Operational Boundary
Gross Debt
Net Debt
31/03/2015
14/04/2015
28/04/2015
12/05/2015
26/05/2015
09/06/2015
23/06/2015
07/07/2015
21/07/2015
04/08/2015
18/08/2015
01/09/2015
15/09/2015
29/09/2015
13/10/2015
27/10/2015
10/11/2015
24/11/2015
08/12/2015
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19/01/2016
02/02/2016
16/02/2016
01/03/2016
15/03/2016
29/03/2016
Date