Report No. **FSD16050**	**London Borough of Bromley** **PART 1 - PUBLIC**	**Agenda** **Item No.**

Decision Maker:	**Resources Portfolio Holder**
Date:	**For pre-decision scrutiny by Executive and Resources PDS Committee on 7th July 2016** **Council 26th September 2016**
Decision Type:	Non-Urgent Executive Non-Key
Title:	**TREASURY MANAGEMENT - ANNUAL REPORT 2015/16**
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Chief Officer:	Director of Finance
Ward:	Alll

1. Reason for report

1.1 This report summarises treasury management activity during the March quarter and includes the Treasury Management Annual Report for 2015/16, which is required to be reported to full Council. The report ensures that the Council is implementing best practice in accordance with the CIPFA Code of Practice for Treasury Management. The report also includes an update on the Council's investment with Heritable Bank (paragraph 3.16). Investments as at 31st March 2016 totalled £285.5m (excluding the balance of the Heritable investment) and there was £24.4m of temporary external borrowing. For information and comparison, the balance of investments stood at £301.9m as at 31st December 2015 and £254.8m as at 31st March 2015 and, at the time of writing this report (24th June 2016) it stood at £287.6m.

RECOMMENDATION(S)

2.1 The PDS Committee, the Portfolio Holder and the Council are asked to:

(a) note the Treasury Management Annual Report for 2015/16 and

(b) approve the actual prudential indicators within the report.

Corporate Policy

1. Policy Status: Existing policy. To maintain appropriate levels of risk, particularly security and liquidity, whilst seeking to achieve the highest rate of return on investments.

2. BBB Priority: Excellent Council.

Financial

1. Cost of proposal: N/A

2. Ongoing costs: N/A.

3. Budget head/performance centre: Interest on balances

4. Total current budget for this head: £2.741m budget (net interest earnings) in 2015/16; surplus of £1.53m achieved in 2015/16. Budget for 2016/17 £3.491m

5. Source of funding: Net investment income

Staff

1. Number of staff (current and additional): 0.25 fte

2. If from existing staff resources, number of staff hours: 9 hours per week

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Legal

1. Legal Requirement: Non-statutory - Government guidance.

2. Call-in: Call-in is applicable

Customer Impact

1. Estimated number of users/beneficiaries (current and projected): n/a

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Ward Councillor Views

1. Have Ward Councillors been asked for comments? N/A.

2. Summary of Ward Councillors comments:

3. COMMENTARY

General

3.1 Under the requirements of the CIPFA Code of Practice on Treasury Management, the Council is required, as a minimum, to approve an annual treasury strategy in advance of the year, a mid-year review report and an annual report following the year comparing actual activity to the strategy. In practice, the Director of Finance has reported quarterly on treasury management activity for many years, as well as reporting the annual strategy before the year and the annual report after the year-end. This report includes details of investment performance in the final quarter of 2015/16 and the annual report for the whole of the financial year 2015/16. The 2015/16 annual treasury strategy, including the MRP (Minimum Revenue Provision) Policy Statement and prudential indicators, was originally approved by Council in February 2015. The review and amendments to the strategy (comprising an increase in the total investment limit for pooled investment vehicles from £25m to £40m) were approved by Council in October 2015.

3.2 Recent changes in the regulatory environment place a much greater onus on Members for the review and scrutiny of treasury management policy and activities. This report is important in that respect, as it provides details of the actual position for treasury activities and highlights compliance with the Council's policies previously approved by Members.

3.3 The Council has monies available for Treasury Management investment as a result of the following:

(a) Positive cash flow;
(b) Monies owed to creditors exceed monies owed by debtors;
(c) Receipts (mainly from Government) received in advance of payments being made;
(d) Capital receipts not yet utilised to fund capital expenditure;
(e) Provisions made in the accounts for liabilities e.g. provision for outstanding legal cases which have not yet materialised;
(f) General and earmarked reserves retained by the Council.

3.4 Some of the monies identified above are short term and investment of these needs to be highly "liquid", particularly if it relates to a positive cash flow position, which can change in the future. Future monies available for Treasury Management investment will depend on the budget position of the Council and whether the Council will need to substantially run down capital receipts and reserves. Against a backdrop of unprecedented cuts in Government funding (which will require the Council to make revenue savings to balance the budget in future years), there is a likelihood that such actions may be required in the medium term, which will reduce the monies available for investment.

3.5 The Council has also identified an alternative investment strategy relating to property investment. To date, this has resulted in actual and planned acquisitions which generated £3m income in 2015/16, and full-year income of £4m. This is based on a longer term investment timeframe of at least 3 to 5 years. After allowing for foregone treasury management interest earnings (£0.5m), the financial forecast assumes net increased income of £4.5m from the acquisitions. This alternative investment ensures that the monies available can attract higher yields over the longer term.

3.6 A combination of lower risk investment relating to Treasury Management and a separate investment strategy in the form of property acquisitions (generating higher yields and risks) provides a balanced investment strategy. Any investment decisions will also need to consider the likelihood that interest rates will increase at some point. The available resources for the medium term, given the ongoing reductions in Government funding, will need to be regularly reviewed.

Treasury Performance in the quarter and year ended 31st March 2016

3.7 **Borrowing:** Between 29th February and 31st March 2016, some short-term temporary borrowing was required. This was primarily due to activity in quarter four, mainly relating to the purchase of three investment properties and an anticipated capital receipt not being realised. The borrowing, all from other Local Authorities, had an average principal over this period of £10.4m at an average rate of 0.42% (total interest cost £4k). As at 31st March, there was a total outstanding of £24.4m, which was fully repaid by 4th April 2016. No other borrowing was required for the earlier part of the year.

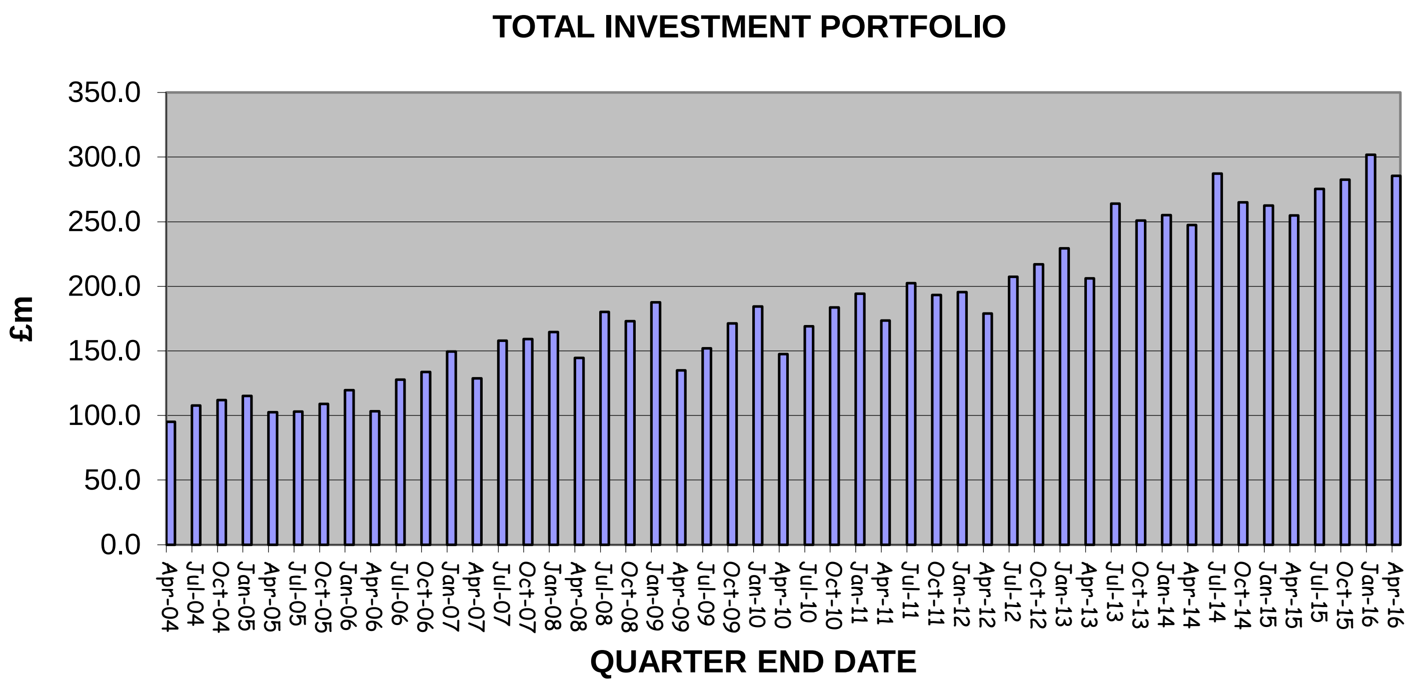
3.8 **Investments:** No investments were placed in the March quarter. The following table sets out details of investment activity during the March quarter and the whole of the financial year 2015/16:-

	Qtr ended 31/03/16		1/4/15 to 31/03/16	
Main investment portfolio	**Deposits**	**Ave Rate**	**Deposits**	**Ave Rate**
	£m	**%**	**£m**	**%**
Balance of "core" investments b/f	247.50	1.41	207.50	1.29
New investments made in period	0.00	0.00	70.00	1.33
Investments redeemed in period	-7.00	0.97	-37.00	0.84
"Core" investments at end of period	240.50	1.43	240.50	1.43
Money Market Funds	0.00	para 3.13	0.00	para 3.13
Santander 180 day notice account	10.00	para 3.14	10.00	para 3.14
CCLA Property Fund	25.00	para 3.15	25.00	para 3.15
Diversified Growth Funds	10.00	para 3.15	10.00	para 3.15
Total investments at end of period	**285.50**	**n/a**	**285.50**	**n/a**

3.9 Details of the outstanding investments at 31st March 2016 are shown in maturity date order in Appendix 1 and by individual counterparty in Appendix 2. An average return of 1% was prudently assumed for new investments in the 2015/16 budget in line with the estimates provided by the Council's external treasury advisers, Capita, and with officers' views. The average return on the new "core" investments placed during 2015/16 was 1.33%, compared to the average LIBID rates of 0.36% for 7 days, 0.46% for 3 months, 0.61% for 6 months and 0.90% for 1 year. The improved average rate earned on new investments placed in 2015/16 mainly reflects longer-term deposits placed with other local authorities and banks and compares favourably with the budget assumption.

3.10 Reports to previous meetings have highlighted the fact that options with regard to the reinvestment of maturing deposits have become seriously limited in recent years following bank credit rating downgrades. Changes to lending limits and eligibility criteria, most recently in October 2014 (an increase of £40m (from £40m to £80m) in the lending limits of both Lloyds and RBS and an increase in the maximum period from 2 years to 3 years) have alleviated this to some extent, but there are still not many investment options available other than placing money with instant access accounts at relatively low interest rates. Active UK banks on the Council's list now comprise only Lloyds, RBS, HSBC, Barclays, Santander UK and Nationwide and all of these have reduced their interest rates significantly in recent years. The Director of Finance will continue to monitor rates and counterparty quality and take account of external advice prior to any investment decisions.

3.11 The chart below shows total investments at quarter-end dates back to 1st April 2004 and shows how available funds have increased steadily over the years. This has been a significant contributor to the over-achievement of investment income against budgeted income in recent years.



Interest Rate Forecast

3.12 Base rate has now been 0.5% since March 2009 and the latest forecast by Capita Treasury Solutions (in May 2016) is for it to begin to slowly rise from early 2017 (a quarter later than the previous estimate given in January 2016). For comparison, Capita's latest two interest rate forecasts are shown below.

Date	LATEST FORECAST (May 16)				PREVIOUS FORECAST (Jan 16)			
	Base Rate	3 month Libid	6 month Libid	1 year Libid	Base Rate	3 month Libid	6 month Libid	1 year Libid
Jun-16	0.50%	0.50%	0.70%	1.00%	0.50%	0.50%	0.70%	1.00%
Sep-16	0.50%	0.50%	0.70%	1.00%	0.50%	0.60%	0.80%	1.10%
Dec-16	0.50%	0.60%	0.80%	1.10%	0.75%	0.80%	0.90%	1.20%
Mar-17	0.75%	0.80%	0.90%	1.20%	0.75%	0.90%	1.00%	1.30%
Jun-17	0.75%	0.80%	1.00%	1.30%	1.00%	1.00%	1.20%	1.50%
Sep-17	1.00%	1.00%	1.20%	1.50%	1.00%	1.10%	1.30%	1.60%
Dec-17	1.00%	1.10%	1.40%	1.70%	1.25%	1.30%	1.50%	1.80%
Mar-18	1.25%	1.30%	1.60%	1.90%	1.25%	1.40%	1.60%	1.90%
Jun-18	1.25%	1.30%	1.70%	2.00%	1.50%	1.50%	1.70%	2.00%
Sep-18	1.50%	1.60%	1.80%	2.10%	1.50%	1.60%	1.80%	2.10%
Dec-18	1.50%	1.80%	2.00%	2.30%	1.75%	1.80%	2.00%	2.30%
Mar-19	1.75%	1.90%	2.20%	2.40%	1.75%	1.90%	2.20%	2.40%

However, these projections do not reflect any potential impact of the referendum decision to leave the EU, and although due in July, an updated forecast may not be available until after the meeting of this committee.

Other accounts

3.13 <u>Money Market Funds</u>

The Council currently has 6 AAA-rated Money Market Fund accounts, with Prime Rate, Ignis, Insight, Blackrock, Fidelity and Legal & General, all of which have a maximum investment limit of

£15m. In common with market rates for fixed-term investments, interest rates on money market funds have fallen considerably in recent years. The Ignis and Legal & General funds currently offer the best rate (around 0.53%). The total balance held in Money Market Funds has fluctuated considerably during the year, moving from £22.3m as at 1st April 2015 to £17.8m as at 30th June 2015, £20.1m as at 30th September 2015, £9.4m as at 31st December 2015 and zero as at 31st March 2016. The total peaked at £57.2m in October 2015 and averaged £27.7m over the whole year. The Money Market Funds currently offer the lowest interest of all eligible investment vehicles with the exception of the Government Debt Management Account Deposit Facility (currently 0.25%). During the year, funds have been withdrawn to fund other, more attractive investments, most recently in the December quarter, when the Council invested £10m in Santander's 180 call account at 1.15%, £5m with Lloyds Bank at 1.82% for 3 years, and £10m with Lancashire County Council at 1.5% for 3 years.

Money Market Funds	**Date Account Opened**	**Ave. Rate 2015/16**	**Ave. Daily balance 2015/16**	**Actual balance 31/03/16**	**Latest Balance 24/06/16**	**Latest Rate 24/06/16**
		%	**£m**	**£m**	**£m**	**%**
Prime Rate	15/06/2009	0.48	8.2	0.0	8.0	0.53
Ignis	25/01/2010	0.048	11.3	0.0	13.5	0.52
Insight	03/07/2009	0.47	2.8	0.0	0.0	0.50
Legal & General	23/08/2012	0.46	5.4	0.0	15.0	0.54
Blackrock	16/09/2009	-	-	0.0	0.0	0.41
Fidelity	20/11/2002	-	-	0.0	0.0	0.42
TOTAL			27.7	0.0	36.5	

3.14 Santander 180 Day Notice Account

In November 2015, £10m was placed with Santander UK in their 180 day notice account at a rate of 1.15%. This is a very good rate for (potentially) 6 month money, but notice was given in May 2016 to ensure that this did not breach the one year maximum permitted with Santander.

3.15 Pooled Investment Schemes

In September 2013, the Portfolio Holder and Full Council approved the inclusion of collective (pooled) investment schemes as eligible investment vehicles in the Council's Investment Strategy with an overall limit of £25m and a maximum duration of 5 years. The limit was subsequently increased to £40m by Council in October 2015. Such investments would require the approval of the Director of Finance in consultation with the Resources Portfolio Holder.

CCLA Property Fund
Following consultation between the Director of Finance and the Resources Portfolio Holder, an account was opened in January 2014 with the CCLA Local Authorities' Property Fund and an initial deposit of £5m was made, followed by further deposits of £5m in July 2014, £5m in March 2015 and £10m in October 2015. The investment in the CCLA Fund is viewed as a medium to long-term investment and dividends are paid quarterly. The investment returned 5.25% net of fees in 2014/15 and 5.02% (net) in 2015/16.

Diversified Growth Funds
In October 2014, the Council approved the inclusion of investment in diversified growth funds in the investment strategy and, in December, £5m was invested with both Newton and Standard Life. The Funds both performed very well in just over three months to 31st March 2015; the Newton Fund returning 21.5% and the Standard Life Fund returning 21.9%. In accordance with the Council decision, interest equivalent to 27% of the total dividend was transferred to the Parallel Fund, set up in 2014/15 with an opening balance of £2.7m to mitigate the potential

revenue impact of future actuarial Pension Fund valuations. However, performance has not been so impressive in 2015/16, with the Newton Fund returning 0.85% (net – an overall gain of £43k) and the Standard Life Fund returning -5.05% (net – an overall loss of £253k). The overall net gains since inception have been 5.3% (£337k) and 0.7% (£47k) for the Newton and Standard Life funds respectively. This downturn in performance echoes that seen in the Pension Fund's Diversified Growth Funds (and Global Equities Funds) during 2015/16. It should be noted that these types of investments should be considered as longer term investments over a three to five year period.

3.16 Investment with Heritable Bank

Members will be aware from regular updates to the Resources Portfolio Holder and the Executive that the Council had £5m invested with the Heritable Bank, a UK subsidiary of the Icelandic bank, Landsbanki. In October 2008, the bank was placed in administration and the investment was frozen. An initial dividend was paid to the Council in July 2009 and, since then, a further 14 dividends have been received. To date, a total of £4,985k has been received (98% of the total claim of £5,087k), leaving a balance of £102k (2%). Council officers and its external advisers remain hopeful of a full recovery.

3.17 External Cash Management

Since 2003, external cash managers, Tradition UK Ltd, have managed a proportion of the Council's cash portfolio (£10m up to 2010 and £20m from then) and have provided advice and information on treasury management matters. In 2014/15, Tradition UK achieved a return of 1.28%, which compared with the in-house team rate of 1.06% for "core" investments (1.55% including investments with the pooled vehicles). During 2015/16, Tradition UK returned 1.42% against the in-house team return of 1.43% for "core" investments (1.25% including pooled vehicles). As reported to the Executive and Resources Committee on 3rd February 2016, the contract with Tradition was terminated in December 2015, resulting in a fee saving of £12,500 per annum. The table below shows details of their current deposits, all of which have been placed for periods of two or three years.

Bank	Sum	Start Date	Maturity	Period	Rate
Lloyds	£7.5m	18/08/14	18/08/16	2 years	1.28%
RBS	£5.0m	26/08/14	26/08/16	2 years	Min 1.52%; max 2.00% (linked to 3 month Libor)
West Dumbartonshire Council	£2.5m	26/03/14	24/03/17	3 years	1.60%
Perth & Kinross Council	£5m	23/03/14	24/03/17	3 years	1.45%

Actual prudential indicators for 2015/16

3.18 The old capital control system was replaced in April 2004 by a prudential system based largely on self-regulation by local authorities themselves. At the heart of the system is The Prudential Code for Capital Finance in Local Authorities, developed by CIPFA. The Code requires the Council to set a number of prudential indicators designed to monitor and control capital expenditure, financing and borrowing. The indicators for 2015/16 were approved by the Executive and the Council in February 2015 and were revised and updated in December 2015. Appendix 3 sets out the actual performance in 2015/16 against those indicators.

Economic Background during 2015/16 (provided by Capita Treasury Solutions)

3.19 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.

3.20 These concerns have caused sharp market volatility in equity prices during the year with corresponding impacts on bond prices and bond yields due to safe haven flows. Bank Rate, therefore, remained unchanged at 0.5% for the seventh successive year. 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, 2015 has been disappointing with growth falling steadily from an annual rate of 2.9% in quarter 1 2015 to 2.1% in quarter 4.

3.21 The Funding for Lending Scheme, announced in July 2012, resulted in a flood of cheap credit being made available to banks which then resulted in money market investment rates falling materially. These rates continued at very low levels during 2015/16.

3.22 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.

3.23 The ECB had announced in January 2015 that it would undertake a full blown quantitative easing programme of purchases of Eurozone government and other bonds starting in March at €60bn per month. This put downward pressure on Eurozone bond yields. There was a further increase in this programme of QE in December 2015. The anti-austerity government in Greece, elected in January 2015 eventually agreed to implement an acceptable programme of cuts to meet EU demands after causing major fears of a breakup of the Eurozone. Nevertheless, there are continuing concerns that a Greek exit has only been delayed.

3.24 As for America, the economy has continued to grow healthily on the back of resilient consumer demand. The first increase in the central rate occurred in December 2015 since when there has been a return to caution as to the speed of further increases due to concerns around the risks to world growth.

3.25 On the international scene, concerns have increased about the slowing of the Chinese economy and also its potential vulnerability to both the bursting of a property bubble and major exposure of its banking system to bad debts. The Japanese economy has also suffered disappointing growth in this financial year despite a huge programme of quantitative easing, while two of the major emerging market economies, Russia and Brazil, are in recession. The situations in Ukraine, and in the Middle East with ISIS, have also contributed to volatility.

Regulatory Framework, Risk and Performance

3.26 The Council's treasury management activities are regulated by a variety of professional codes and statutes and guidance:

- The Local Government Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;

- The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing that may be undertaken (although no restrictions have been made to date);

- Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act;

- The SI requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities;

- The SI also requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services;

- Under the Act, the CLG has issued Investment Guidance to structure and regulate the Council's investment activities;

- Under section 238(2) of the Local Government and Public Involvement in Health Act 2007, the Secretary of State has taken powers to issue guidance on accounting practices. Guidance on Minimum Revenue Provision was issued under this section on 8th November 2007.

3.27 The Council has complied with all of the above relevant statutory and regulatory requirements, which limit the levels of risk associated with its treasury management activities. In particular, its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means that its capital expenditure is prudent, affordable and sustainable and its treasury practices demonstrate a low risk approach.

4. POLICY IMPLICATIONS

4.1 In line with government guidance, the Council's policy is to seek to achieve the highest rate of return on investments whilst maintaining appropriate levels of risk, particularly security and liquidity.

5. FINANCIAL IMPLICATIONS

5.1 An average rate of interest of 1.39% was achieved in 2015/16, including 1.33% on all new "core" investments placed during the year (compared to the budget assumption of 1%), money market funds and pooled investment schemes. The final outturn for net interest on investments and borrowing in 2015/16 was £4,269k compared to the budget of £2,741k. This was in no small part due to returns on the CCLA Property Fund. The other main contributory factor, apart from the higher interest rate earned on new investments, was the fact that average investment balances during the year (£267m) were higher than expected.

5.2 With regard to 2016/17, there is still no sign of interest rates improving and an average rate of 1% has again been prudently assumed for interest on new fixed term deposits in the 2016/17 revenue budget, in line with the estimates provided by the Council's external treasury advisers, Capita, earlier in the year and with officers' views. The Bank of England base rate is still expected to rise, but the expected start of the rise has been put back to early 2017 and could be even later. There have been no improvements to counterparty credit ratings, as a result of which the restrictions to investment opportunities that followed ratings downgrades in recent years have still been in place. However, the increases in the limits for the two part-nationalised banks (Lloyds and RBS) approved by the Council in October, together with higher rates from longer-term deals placed with other local authorities, higher average balances than anticipated and the strong performance of the CCLA Property Fund have enabled the 2016/17 budget to be increased to £3,491k, after allowing for foregone interest earnings as a result of further property acquisitions.

Non-Applicable Sections:	Legal and Personnel Implications
Background Documents: (Access via Contact Officer)	CIPFA Code of Practice on Treasury Management CIPFA Prudential Code for Capital Finance in Local Authorities CLG Guidance on Investments External advice from Capita Treasury Solutions