Report of	Meeting	Date
Chief Executive	Governance Committee	23 September 2015

TREASURY STRATEGY AND PRUDENTIAL INDICATORS 2015/16 - MID TERM REVIEW

PURPOSE OF REPORT

1. To report on performance and compliance with Prudential Indicators in financial year 2015/16 to the end of August.

RECOMMENDATION(S)

2. That the report be noted.

3. That Governance Committee requests that Council should approve changes to Prudential Indicators 1 and 2, as presented in Tables 1 and 2 of this report.

EXECUTIVE SUMMARY OF REPORT

4. The report takes into account changes to revenue and capital budgets reported to Executive Cabinet and Council during 2015/16. Prudential Indicators have been updated to reflect rephasing of capital expenditure and changes to financing.

5. The Capital Financing Requirement (CFR) has been recalculated to reflect rephasing of capital expenditure to be financed by borrowing from 2014/15. Net borrowing – gross borrowing and other long-term liabilities less surplus cash invested – is expected to be much lower than the CFR in 2015/16 because of use of internal cash balances where possible.

6. Average interest earned is 0.52% to the end of August. As in 2014/15, cash balances have been used as a source of internal borrowing to minimise external borrowing at higher rates of interest, thereby achieving revenue budget savings.

Confidential report Please bold as appropriate	Yes	**No**

CORPORATE PRIORITIES

7. This report relates to the following Strategic Objectives:

Involving residents in improving their local area and equality of access for all		A strong local economy	
Clean, safe and healthy communities		An ambitious council that does more to meet the needs of residents and the local area	

BACKGROUND

8. Special Council of 3 March 2015 approved the Prudential Indicators for 2015/16 to 2017/18; the Treasury Management Strategy and Treasury Indicators for 2015/16; the Annual Investment Strategy 2015/16; and the Annual Minimum Revenue Provision (MRP) Policy for 2015/16.

9. The Treasury Management Annual Report for 2014/15 was presented to Governance Committee of 24 June 2015. Changes to total capital expenditure in 2014/15, and the financing of it by borrowing (external and internal), have an impact on Prudential Indicators in 2015/16. See Table 1 and Table 2 below.

10. This report reflects rephasing of capital expenditure, and other changes to the capital programme and revenue budgets, reported to Executive Cabinet and Council during 2015/16.

11. The Code of Practice for Treasury Management requires Councils to review their treasury strategies and activities half yearly. This report satisfies that requirement.

PRUDENTIAL INDICATORS

Capital Expenditure 2015/16

12. The Prudential Indicator reported on 3 March 2015 took account of estimated capital expenditure and sources of financing from 2014/15 to 2017/18. The Capital Expenditure prudential indicator for 2015/16 has been updated to include expenditure rephased from 2014/15 to 2015/16, and other changes to expenditure and financing budgets, as shown in the table below.

Table 1 - Capital Expenditure	2015/16 Estimate £'000	Net Changes £'000	2015/16 Revised £'000
Capital expenditure incurred directly by the Council	9,214	996	10,210
Less Capital resources			
Capital receipts	649	27	676
Grants & contributions	1,869	822	2,691
Revenue and reserves	2,617	(108)	2,509
Unfinanced amount (affects the CFR)	**4,079**	**255**	**4,334**

13. The unfinanced total represents the expenditure that would be financed by Prudential Borrowing, whether external or use of internal balances.

14. Should additional capital projects be added to the Capital Programme during the remainder of 2015/16, in particular any that would require further prudential borrowing, then further revisions to Prudential Indicators would be required. This would be the case even if the intention is that the financing costs of new assets should be met from rental income receivable on completion.

Capital Financing Requirement (CFR) 2015/16

15. The CFR measures the indebtedness resulting from the Council's Capital Programme. It increases when the Council incurs unfinanced capital expenditure or leasing liabilities. The CFR is used to calculate the charge to the revenue account for debt repayment known as the Minimum Revenue Provision or MRP.

16. The CFR for the current year has been recalculated to take account of the rephasing of capital expenditure from 2014/15 to 2015/16, and other changes reflected in Table 1 above. Of the £33.200m CFR as at 1 April 2015, £23,206m is in respect of Market Walk.

Table 2 - Capital Financing Requirement (CFR)	**2015/16 Estimate £'000**	**Net Changes £'000**	**2015/16 Revised £'000**
Estimated CFR at year-end	36,819	177	36,996
Reasons for the annual change in the CFR			
Reduction in CFR as at 31/3/15	0	(39)	(39)
Unfinanced capital expenditure (see Table 1)	4,079	255	4,334
Voluntary Set Aside (re leasing of vehicles)	0	(48)	(48)
Annual revenue charge (MRP)	(499)	9	(490)

The CFR and Borrowing 2015/16

17. The Prudential Code requires that borrowing net of investments should not exceed the CFR for the preceding year plus any anticipated increase in the current and next two years. This is in order to ensure that Councils borrow only for capital investment purposes. As at 31 March 2015, net borrowing as reported in the Treasury Management Annual Report 2014/15 was £17.574m and therefore was well below the CFR at the same date. Net borrowing will not exceed the CFR in 2015/16, and the actual year-end figure will be confirmed in the Treasury Management Annual Report for the financial year. However, as explained above, the CFR Prudential Indicator may need to be updated should any additional schemes to be funded by prudential borrowing be added to the Capital Programme during 2015/16.

18. As there is a large margin between net borrowing and the CFR, the Council could take additional external borrowing should it need to top-up cash balances. However, there would be a "carrying cost" of additional borrowing, because the interest rates payable would exceed the interest rates receivable on the cash balances. As indicated in Table 3 below, the average rate of interest earned this year to November is 0.52%, whereas interest payable on new PWLB loans would be 2.3% to 3.4% (see Appendix B). Even though there would be a "carrying cost" of taking additional PWLB loans, this may prove necessary to achieve savings in the longer run if significant increases in interest rates became imminent.

Operational Boundary for External Debt 2015/16

19. The Operational Boundary for external debt should reflect the most likely, but not worst case, scenario consistent with the Council's approved budgets. Gross borrowing and other long-term liabilities should not exceed the Operational Boundary. The figure approved on 3 March 2015 was £32.674m, being the forecast gross borrowing and other long-term

liabilities as at 31 March 2016. Actual borrowing at that date is expected to be lower, because as much as possible of the CFR is matched by internal rather than external borrowing. Use for internal borrowing is the most effective use of the Council's cash balances while available. The Operational Boundary was set at a value based on the CFR to allow additional external borrowing should cash balances be depleted, without breaching the Prudential Indicator.

Authorised Limit 2015/16

20. The Authorised Limit should allow headroom above the Operational Boundary to accommodate the fluctuations that can occur in cash flows. The figure approved for 2015/16 was £34.674m, and there is no reason to amend this at present.

Ratio of Financing Costs to the Revenue Stream 2014/15

21. The Ratio of Financing Costs to the Revenue Stream shows the percentage of the Council's income from Government grants and council tax that has been used to meet interest costs and debt repayment. The actual figure for 2015/16 will be presented in the Treasury Management Annual Report 2015/16 in June 2016.

Incremental Impact of Capital Investment Decisions 2015/16

22. The Incremental Impact of Capital Investment Decisions measures the cumulative impact of capital expenditure on the revenue budget. It is not possible to make a meaningful comparison against this indicator other than when it is restated in the annual Treasury Strategy, which will be presented to Council in February 2016.

TREASURY ACTIVITY

23. Investment activity up to the end of August 2015 is summarised in the following table.

Table 3 - Investment Activity	**Average Daily Investment £'000**	**Earnings to 31/8/15 £**	**Average Rate %**
Fixed Term Deposits	2,000	5,868	0.70
Call Accounts	2,549	4,265	0.40
Money Market Funds	284	474	0.40
Total	**4,833**	**10,607**	**0.52**

Compared to 2014/15, the main change is the reduction in the average rate offered on term deposits. However, because of the lower balance available to invest, it has not been possible to invest for longer periods in order to achieve higher interest rates.

A full list of current investments is shown below.

Table 4 - Investments as at 31/8/15					
Counterparty	**Type**	**Amount £**	**Rate %**	**Invested**	**Maturity**
Bank of Scotland Corporate	Term deposit	2,000,000	0.70	01/04/2015	01/10/2015
Barclays	Call account	1,839,627	0.40	On call	

A separate report on this agenda reviews the current list of Financial Institutions and Investment Criteria, and proposes changes that would tend to improve yield without increasing risk.

24. The average interest earned of 0.52% exceeds the benchmark of 0.35% (being the average LIBID 7 day rate). A key performance indicator for Shared Financial Services is that the rate achieved should exceed the 7 day LIBID plus 10%, which was 0.385%. Therefore the target was achieved.

25. The Council's treasury advisors, Capita Asset Services, have provided a detailed commentary on interest rate forecasts, which is presented as Appendix B. Bank rate and PWLB borrowing rate forecasts are given from September quarter 2015 through to June quarter 2018. Compared to the rates forecast presented to Council in March 2015, PWLB rates are currently a little lower than expected, and are not considered likely to increase by as much as previously suggested by March quarter of 2018. An increase in Bank rate was expected in the March quarter of 2016, whereas now it is considered that the first increase could be in June quarter of 2016.

TREASURY CONSULTANTS' ADVICE

26. Appendix A presents the advice of Capita Asset Services in respect of economic matters in the first quarter of 2015/16. In addition, a detailed commentary on interest rate forecasts is presented as Appendix B.

IMPLICATIONS OF REPORT

27. This report has implications in the following areas and the relevant Directors' comments are included:

Finance	✓	Customer Services	
Human Resources		Equality and Diversity	
Legal		Integrated Impact Assessment required?	
No significant implications in this area		Policy and Communications	

COMMENTS OF THE STATUTORY FINANCE OFFICER

28. This report complies with statutory requirements. Statistical content is consistent with the assumptions in the approved capital and revenue budgets for 2015/16, including changes approved during the year.

COMMENTS OF THE MONITORING OFFICER

29. The Monitoring Officer has no comments.

GARY HALL
CHIEF EXECUTIVE

There are no background papers to this report.

Report Author	Ext	Date	Doc ID
Michael Jackson	5490	13 September 2015	Treasury Strategy & Prudential Indicators 2015-16.docx