APPENDIX A

TREASURY MANAGEMENT POSITION FOR THE THIRD QUARTER OF 2016/17

1. GOVERNANCE

The Treasury Management Policy Statement, Annual Minimum Revenue Provision for Debt Repayment Statement and Annual Investment Strategy approved by the City Council on 22 March 2016 and amended by the City Council on 11 October 2016 provide the framework within which treasury management activities are undertaken.

2. COMBINED BORROWING AND INVESTMENT POSITION (NET DEBT)

On 31 December 2016 the Council had gross debt including finance leases and private finance initiative (PFI) schemes of £563m and gross investments of £474m giving rise to a net debt of £89m. The current high level of investments has arisen from the Council's earmarked reserves and borrowing in advance of need to take advantage of low borrowing rates thus securing cheap funding for the Council's capital programme. The current high level of investments does increase the Council's exposure to credit risk, ie. the risk that an approved borrower defaults on the Council's investment. In the interim period when investments are high in advance of capital expenditure being incurred, there is also a short term risk that the rates (and therefore the cost) at which money has been borrowed will be greater than the rates at which those loans can be invested. The difference between current borrowing and investment rates is 1.25%. This should provide longer term savings through reduced borrowing costs.

3. BORROWING ACTIVITY

The Council employs Capita Asset Services to provide interest rate forecasts. The forecast overall longer run trend is for gilts and Public Works Loans Board (PWLB) rates to rise, albeit gently, with 25 year rates expected to rise from their current 3.0 % to 3.4% by March 2020.

Borrowing rates were particularly low in the summer of 2016 (see Appendix B) and the Council borrowed £94.0m from the Public Works Loans Board (PWLB) repayable in equal instalments of principal over 25 years at an average rate of 2.37%.

The Council also rescheduled a £10.5m loan in September 2016. The effect of the rescheduling was to replace a 15 year equal instalment of principal loan with a 50 year maturity loan and to reduce the interest rate from 4.52% to 2.09% in return for the payment of a premium of £3.2m. This has generated an annual saving of £47,000 per annum after taking account of the cost of financing the premium and in overall terms resulted in a total saving (in net present value* terms) of £1.1m.

* Net present value is a method of making a like for like comparison of different cash flows over time

The Council's gross debt at 31 December 2016 of £563m is within the Council's authorised limit (the maximum amount of borrowing permitted by the Council) of £618m and the Council's operational boundary (the maximum amount of borrowing that is expected) of £600m. The Council aims to have a reasonably even maturity profile so that the Council does not have to replace a large amount of borrowing in any particular year when interest rates might be high. The maturity profile of the Council's borrowing (Appendix C) is within the limits contained in the Council's Treasury Management Policy (see recommendation b).

4. INVESTMENT ACTIVITY

Investment rates followed a falling trend in the first four months of 2016/17 with a sharp fall of around 0.25% in line with the reduction in the base rate in August. Base rate is not forecast to rise from 0.25% until June 2019 and then to only rise slowly. Since August investment rates have been broadly stable (see Appendix D).

The Council's investment portfolio has increased by £102.4m from £371.8m at 1 April to £474.2m. The average return on the Council's investments for the first nine months of 2016/17 was 1.12%. This compares with 1.09% for the first four months of 2016/17. The Council's investment returns are benchmarked by Capita Asset Services and at the end of September 2016 the average return on the Councils investments of 1.06% exceeded the risk adjusted benchmark return of 0.89% by 0.17%. The Council’s budgeted investment return for 2016/17 is £3.2m and performance for the year to date is £1.6m above budget. This was due to obtaining better interest rates and having more cash to invest than had been anticipated largely due to borrowing £94.0m in 2016/17 to take advantage of low PWLB rates. The additional investment returns are partly offset by additional borrowing costs of £1.3m. The duration of the Council's investments was within the limits set in the Council's Treasury Management Policy (see table in recommendation c).

The Council's approved Investment Strategy sets an investment limit of £20m for Housing Associations. On 16 December the formerly independent Derwent Housing Association became a subsidiary of Places for People Group. At this time the Council had £20.0m invested with both Derwent Housing Association and Places for People. The acquisition to form a single entity has resulted in the investment counter party limit of £20.0m for Places for People Group being exceeded by £20.0m. £5.5m of investments in Places for People matured on 27 December 2016 so that on 31 December 2016 the investment counterparty limit for Places for People Group was exceeded by £14.5m. Other investments in Places for People Group will mature in June and July 2017 so that on 29 July 2017 the counterparty limit for Places for People Group will be exceeded by £4.5m. The Council's investments with Places for People Group will fall below the investment counterparty limit on 2 June 2018 following a £5m maturity. The investments in Places for People are based on a contractual agreement that does not provide for early repayment. No further investments will be placed with Places for People Group until the Council's investments with Places for People Group are below their investment counter party limit.

Between 7 October and 15 November £5m was invested in an enhanced money market fund managed by Royal London Asset Management with a single AAA credit rating. Industry practice is for enhanced money market funds to have a single credit rating. The Council's Treasury Management Policy requires two credit ratings of at least AA and is therefore at variance with industry practice. It is intended to update the Treasury Management Policy in March to reflect the necessary changes to bring the Council's policy into line with industry practice.

5. INTEREST RATE EXPOSURES

Fixed interest rates avoid the risk of budget variances caused by interest rate movements, but prevent the Council from benefiting from falling interest rates on its borrowing or rising interest rates on its investments. The Council's net fixed interest rate borrowing at 31 December was £286m which was within the limit set in the Treasury Management Policy of £358m. Variable interest rates expose the Council to the benefits and dis-benefits of interest rate movements and can give rise to budget variances. The Council's net variable interest rate investments at 31 December was £278m which was within the limit set in the Treasury Management Policy of £444m.