

Title of meeting: Governance and Audit and Standards Committee
Cabinet
City Council

Date of meeting: Governance and Audit and Standards Committee 15 September 2017
Cabinet 28 September 2017
City Council 17 October 2017

Subject: Treasury Management Outturn Report 2016/17

Report by: Director of Finance and Information Services (Section 151 Officer)

Wards affected: All

Key decision: No

Full Council decision: Yes

1. Executive Summary

The Chartered Institute of Public Finance & Accountancy's (CIPFA) Prudential Code of Practice requires local authorities to calculate prudential indicators before the start of and after each financial year.

These end of year indicators are shown at Appendix A of the report for information and noting by members in order to comply with the code.

The CIPFA Code of Practice on Treasury Management also requires the Section 151 Officer to prepare an annual report on the outturn of the previous year. This information is shown in Appendix B of the report.

2. Purpose of Report

To inform members and the wider community of the Council's treasury management activities in 2016/17 and of the Council's treasury management position as at 31 March 2017.

3. Recommendations

It is recommended that:

- (a) The actual prudential indicators based on the unaudited draft accounts , as shown in Appendix A, be noted
- (b) The actual treasury management indicators for 2016/17, as shown in Appendix B, be noted

4. Background

The Local Government Act 2003 requires local authorities to have regard to the Chartered Institute of Public Finance and Accountancy's (CIPFA) Prudential Code for Capital Finance in Local Authorities.

5. Reasons for Recommendations

The net cost of Treasury Management activities and the risks associated with those activities have a significant effect on the City Council's overall finances.

6. Equality Impact Assessment

The contents of this report do not have any relevant equalities impact and therefore an equalities assessment is not required.

7. Legal implications

The Section 151 Officer is required by the Local Government Act 1972 and by the Accounts and Audit Regulations 2015 to ensure that the Council's budgeting, financial management, and accounting practices meet the relevant statutory and professional requirements. Members must have regard to and be aware of the wider duties placed on the Council by various statutes governing the conduct of its financial affairs.

8. Director of Finance & Information Services (Section 151 Officer) comments

All financial considerations are contained within the body of the report and the attached appendices

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Signed by Director of Finance & Information Services (Section 151 Officer)

Appendices:

Appendix A: Prudential Indicators

Appendix B: Treasury Management Outturn

Background list of documents: Section 100D of the Local Government Act 1972

The following documents disclose facts or matters, which have been relied upon to a material extent by the author in preparing this report:

<u>Title of document</u>	Location
1 Information pertaining to the treasury management outturn	Financial Services
2	

ACTUAL PRUDENTIAL INDICATORS**1. SUMMARY OF ACTUAL PRUDENTIAL INDICATORS FOR 2016/17**

Ratio of non-Housing Revenue Account (HRA) financing costs to the non HRA net revenue stream	9.9%
Ratio of HRA financing costs to the HRA net revenue stream	12.4%
Non HRA capital expenditure	£193,853,000
HRA capital expenditure	£30,690,000
Non HRA capital financing requirement at 31 March	£340,948,000
HRA capital financing requirement at 31 March	£151,780,000
External debt at 31 March	£579,343,337

2. RATIO OF FINANCING COSTS TO NET REVENUE STREAM 2016/17

This ratio reflects the annual cost of financing net debt as a proportion of the total revenue financing received. It therefore represents the proportion of the City Council's expenditure that is largely fixed and committed to repaying debt. The higher the ratio, the lower the flexibility there is to shift resources to priority areas and/or reduce expenditure to meet funding shortfalls.

For the General Fund, this is the annual cost of financing debt as a proportion of total income received from General Government Grants, Non Domestic Rates and Council Tax. The ratios of financing costs to net revenue streams for the General Fund in 2016/17 were as follows:

	Original Estimate	Actual
	£'000	£'000
Financing Costs:		
Interest Payable	17,434	18,948
Interest Receivable	(3,051)	(6,365)
Provision for Repayment of Debt	6,819	3,674
Total Financing Costs	21,202	16,257
Net Revenue Stream	159,419	163,480
Ratio of Financing Costs to Net Revenue Stream	13.3%	9.9%

Interest Payable

Interest payable was £1.5m more than the original estimates.

The Council borrowed £15m in 2015/16 and £94m in 2016/17 which had not been included in the original estimates in order to take advantage of relatively low interest rates. Although this should reduce the amount of interest payable in the long term it did result in an additional £2.4m cost in 2016/17.

The Council has entered into a finance lease for the Isle of Wight ferry terminal to enable it to fulfil its obligations to Wightlink following the disposal of the head lease for this site. The Council has paid £0.3m interest on this finance lease in 2016/17.

The highways maintenance private finance initiative (PFI) scheme provides for capital works to bring the highway network up to a specified condition (including interest and principal repayments on loans taken out by the contractor), lifecycle replacement (subsequent capital works), and operation and maintenance. This is an inseparable PFI which means that although the Council knows how much it pays the contractor it does not know how the contractor spends its revenues on the various components of the scheme. The original estimate of the interest on the highways maintenance (PFI) was prepared on the basis of nominal costs in the original financial model prepared at the commencement of the contract in 2004. In preparing the 2016/17 Statement of Accounts it was decided that the estimated indexation used previously may have become less accurate over time and that more accurate estimates may be derived from using actual indexation. This has resulted in the interest on the highways maintenance PFI being £1.8m less than the original estimate. This does not represent an overall saving to the Council as the overall cost of the highways maintenance PFI is broadly the same with additional expense being charged to highways operation and maintenance, capital expenditure charged to revenue balances to cover lifecycle replacement costs, and principal repayment of debt.

The Housing Revenue Account's (HRA) contribution towards interest payable was 0.6m lower than anticipated. This was because the original capital program provided for £15.3m of HRA capital expenditure to be financed from borrowing whereas no HRA capital expenditure was actually financed from borrowing. In addition the original estimates provided for properties worth £3.7m to be appropriated from the General Fund into the HRA which also did not happen.

Interest Receivable

Interest Receivable was £3.3m more than the original estimates. This was due to the Council having more cash to invest than had been anticipated, largely due to additional borrowing, and the interest rates on the Council's investments being higher than had been anticipated.

Provision for the Repayment of Debt

The provision for the repayment of debt was £3.1m less than the original estimate. On 21 March 2017 the City Council approved two amendments to the Council's minimum revenue provision (MRP) for the repayment of debt policy which has reduced total MRP compared to the original estimate.

The Council decided to change the the method of calculating the (MRP) for the repayment of government supported General Fund borrowing (with the exception of finance leases, service concessions and borrowing to fund long term debtors) from a straight 2% to a 50 year annuity in order to better reflect the maturity pattern of the Council's borrowing and avoid the credit risk associated with providing for the repayment of debt long before there is any realistic chance of the debt being repaid.

In recent years the Council has made a number of changes to its methods of calculating its MRP for the repayment of debt. In 2016/17 it was decided to back date the revised MRP calculations in order to ascertain the over provision of MRP made in previous years and the Treasury Management Strategy was amended by the City Council to give the Director of Finance and Information Services (Section 151 Officer) delegated authority to release the £31.3m over provision of MRP into the General Fund over a prudent period. £1.9m, being equal to the General Fund MRP charge excluding provision for finance leases and service concessions (including PFIs), was released to the General Fund in 2016/17.

The reduction in MRP was partly offset by an additional £0.5m being set aside to repay debt connected to the highways maintenance PFI.

Net Revenue Stream

Council Tax receipts, retained non-domestic rates and non-ring fenced government grants were all higher than anticipated in the original budget. This had the effect of further reducing the ratio of financing costs to net revenue stream.

Housing Revenue Account (HRA)

The ratio of Housing Revenue Account (HRA) financing costs to net revenue stream is shown below. For the HRA, this is the annual cost of financing capital expenditure, as a proportion of total gross income received including housing rents and charges.

	Original Estimate	Actual
HRA	12.7%	12.4%

3. ACTUAL CAPITAL EXPENDITURE 2016/17

A revised capital program was approved by the City Council on 14 February 2016. There has been significant under spending against the budget. Much of this was due to slippage or funding not being available. This does not represent additional capital resources. Actual capital expenditure in 2015/16 was as follows:

	Revised Estimate £'000	Actual £'000
Culture, Leisure & Sport	1,867	1,364
Children & Education	8,694	9,273
Environment & Community Safety	6,051	4,402
Health & Social Care (Adults Services)	1,599	1,167
Resources	10,192	6,376
Planning, Regeneration & Economic Development	102,117	116,491
Commercial Port	3,135	1,542
Traffic & Transportation	14,444	11,443
Housing General Fund	2,843	1,756
Local Enterprise Partnership	52,169	40,039
Total Non HRA	203,111	193,853
Housing Revenue Account (HRA)	33,836	30,690
Total	236,947	224,543

Actual capital expenditure was £12.4m below the original revised program. The main variances were as follows:

Environment and Community Safety - £1.6m Underspend

This is due to slippage on coastal flood protection works as a result of staff shortages.

Resources - £3.8m Underspend

£2,260k of this underspend is due to slippage on landlords maintenance, utilities management & investment in solar PV. £303k of capital works to the Guildhall is delayed until external funding can be obtained.

Planning, Regeneration and Economic Development - £14.4m Overspent

The Council has entered into a £10.6m finance lease for the Isle of Wight ferry terminal to enable it to fulfil its obligations to Wightlink following the disposal of the head lease for this site. The effect of this transaction was to repurchase a long term debtor, Wightlink's obligations under its lease, and finance the repurchase from unsupported borrowing. This transaction was not included in the revised capital program.

Commercial Port - £1.6m Underspend

The port regeneration scheme is underspent by £851k following the delayed resolution of a dispute over the final account because the contractor has not responded to communications in a timely manner. The purchase of a link span for berth 4 is underspent by £740k because the actual payment terms are different to those forecast when phasing the budget.

Traffic and Transportation - £3.0m Underspend

There has been slippage of £1,260k on the Tipner Park and Ride scheme due to agreement not being reached on costs. £1,304k of expenditure on the Hard Interchange has slipped into early 2017/18.

Local Enterprise Partnership (LEP) - £12.1m Underspend

A £3m loan to Red Funnel did not go ahead as they were unable to obtain the necessary planning permissions. The £7.7m Centenary Quay scheme will now be funded from another source. A number of other programmes have slipped.

Housing General Fund - £1.1m Underspend

This is mainly due to slippage on disabled facilities grants where catch up work was not started until late in the year. In addition it has proved difficult to spend Section 106 monies as there are very few housing associations building social housing in the city.

4. ACTUAL CAPITAL FINANCING REQUIREMENT

This represents the underlying requirement to borrow for capital expenditure. It takes the total value of the City Council's fixed assets and determines the amount that has yet to be repaid or provided for within the Council's accounts.

The capital financing requirement is increased each year by any new borrowing and reduced by any provision for the repayment of debt. Broadly, the higher the capital financing requirement, the higher the amount that is required to be set aside for the repayment of debt in the following year.

The actual capital financing requirements as at 31st March 2016 were as follows:

	Original Estimate	Actual
	£'000	£'000
Non HRA	380,872	340,948
HRA	168,667	151,780
Total	549,539	492,728

The non HRA capital financing requirement is lower than had been originally estimated. This was largely because the original estimate provided for £66m to be borrowed to finance the acquisition of commercial properties whilst only £37.5m of borrowing was actually required to finance the acquisition of commercial properties. The original estimate also provided for £4.2m to be borrowed to finance the provision of care homes, but it has not been possible to identify sites for these care homes.

The HRA capital financing requirement is lower than the original estimate. The original estimates provided for £15.3m to be borrowed to finance HRA capital expenditure. Most of this money was to provide new council dwellings but much of this expenditure has slipped through delays in obtaining planning permission. In addition a scheme to redevelop Arthur Pope House using £4.8m of borrowing has slipped due to delays in relocating the doctors' surgery. In addition the original estimates provided for properties worth £3.7m to be appropriated from the General Fund into the HRA which would have increased the HRA capital financing requirement but this did not happen.

5. ACTUAL EXTERNAL DEBT

At 31 March 2017, the City Council's level of external debt amounted to £579,343,337 consisting of the following:

- Long Term Borrowing £495,238,598
- Finance leases £12,125,077
- Service concessions (including PFI schemes) £71,979,662

The overall level of debt, excluding debt managed by Hampshire County Council, has increased between 2015/16 and 2016/17 by £96,105,919. This is because the Council borrowed £94m from the PWLB in 2016/17 in order to take advantage of relatively low interest rates and entered into a new £10.6m finance lease for the Isle of Wight Ferry Terminal. This new debt was partly mitigated by principal repayments.

6. CODE OF PRACTICE

The Prudential Code requires local authorities to adopt CIPFA's Code of Practice for Treasury Management in Local Authorities. The City Council has complied with this code.

TREASURY MANAGEMENT DECISIONS 2016/17**1. SUMMARY OF ACTUAL TREASURY MANAGEMENT INDICATORS FOR 2016/17**

Gross debt less investments at 31 March	£142,657,935
Maturity structure of the Council's borrowing:	
- Under 1 year	1%
- 1 to 2 years	4%
- 3 to 5 years	4%
- 6 to 10 years	6%
- 11 to 20 years	22%
- 21 to 30 years	11%
- 31 to 40 years	21%
- 41 to 50 years	31%
Sums invested for periods longer than 364 days at 31 March:	
31/3/2017	£180m
31/3/2018	£106m
31/3/2019	£18m
Fixed interest rate exposure at 31 March	£315m
Variable interest rate exposure at 31 March	(£257m)

2. GOVERNANCE

Treasury management activities were performed within the Prudential Indicators approved by the City Council.

Treasury management activities are also governed by the Treasury Management Policy Statement, Annual Minimum Revenue Provision for Debt Repayment Statement and Annual Investment Strategy approved by the City Council.

3. FINANCING OF CAPITAL PROGRAMME

The 2016/17 capital program was financed as follows:

Source of Finance	Revised Estimate £'000	Actual £'000
Corporate Reserves (including Capital Receipts)	61,291	59,664
Grants & Contributions	83,119	66,561
Revenue & Reserves	26,463	26,579
Long Term Borrowing	66,073	71,739
Total	<u>236,946</u>	<u>224,543</u>

£16.6m less grants and contributions were applied to finance capital expenditure than had been included in the revised capital program. This was largely due to the LEP underspending on schemes which would have been financed from grants and contributions.

4. COMBINED BORROWING AND INVESTMENT POSITION (NET DEBT)

On 31 March 2017 the Council had gross debt including finance leases and private finance initiative (PFI) schemes of £579m and gross investments of £436m giving rise to a net debt of £143m. 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 program. 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 1.26%. This should provide longer term savings through reduced borrowing costs.

5. 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) certainty rates to rise, albeit gently, with 25 year rates expected to rise from their current 2.6% to 3.3% by March 2020.

Borrowing rates were particularly low in the summer of 2016 (see Appendix C) 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%. This represents an effective interest rate of 3.34% after taking account of the premium payable to the PWLB for early redemption 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

In December 2016 the Council entered into a £10.6m finance lease for the Isle of Wight ferry terminal to enable it to fulfil its obligations to Wightlink following the disposal of the head lease for this site. The effect of this transaction was to repurchase a long term debtor, Wightlink's obligations under its lease, and finance the repurchase from unsupported borrowing.

The Council's gross debt at 31 March 2017 of £579m 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 D) is within the limits contained in the Council's Treasury Management Policy.

6. 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 E).

The Council's investment portfolio has increased by £64.9m from £371.8m at 1 April to £436.7m, but the total sums invested for longer than 364 days did remain within the limits approved by the City Council. The average return on the Council's investments during 2016/17 was 1.11%. This compares with 0.97% during 2015/16. The Council's investment returns are benchmarked by Capita Asset Services and as at the end of March 2017 the average return on the Council's investments of 0.89% exceeded the risk adjusted benchmark return of 0.75% by 0.14%. The Council's investment return for 2016/17 was £5.3m and performance for the year was £0.1m above the revised estimate of £5.2m. The duration of the Council's investments was within the limits set in the Council's Treasury Management Policy.

7. 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 March 2017 was £315m which was within the limit set in the 2016/17 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 March 2017 were £257m which was within the limit set in the 2016/17 Treasury Management Policy of £444m.

8. REVENUE COSTS OF TREASURY MANAGEMENT ACTIVITIES IN 2016/17

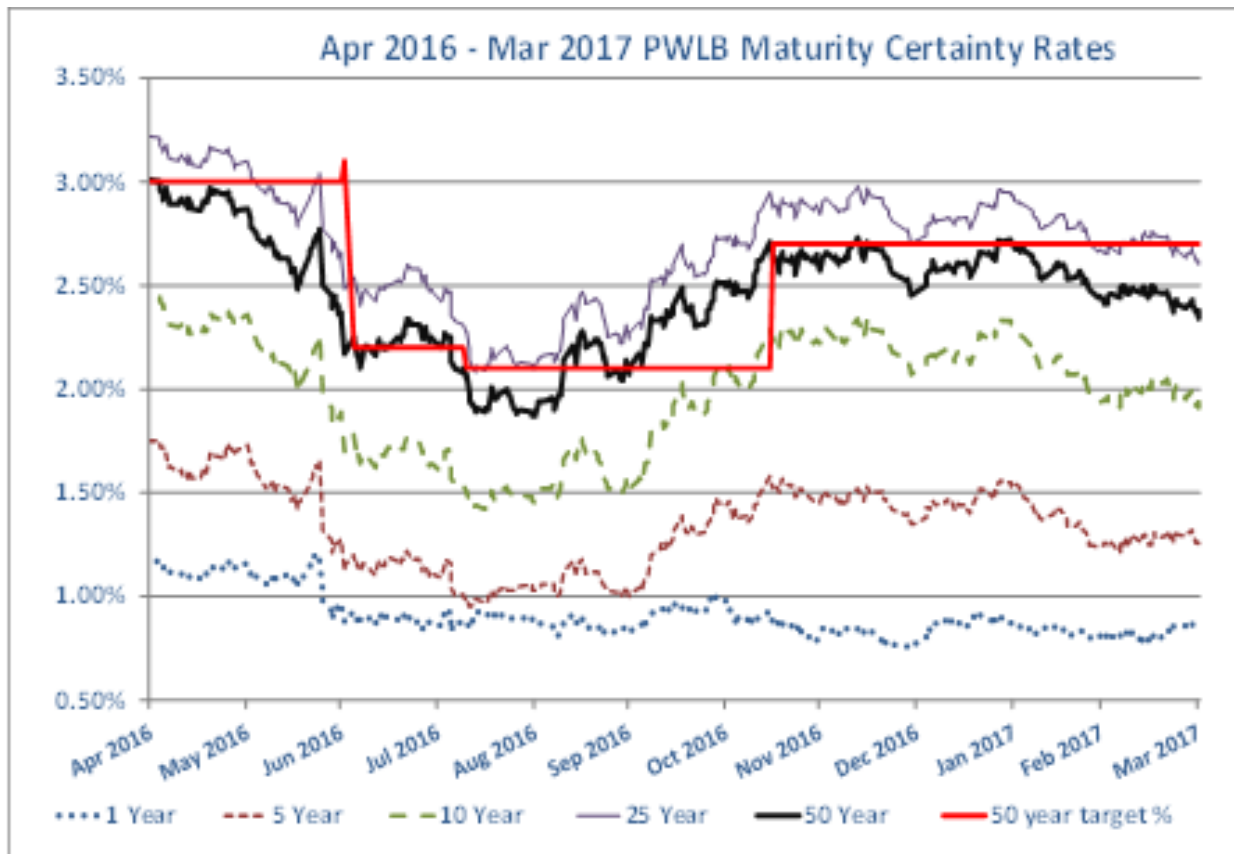
Expenditure on treasury management activities against the revised budget is shown below.

	Revised Estimate 2016/17 £000	Actual 2016/17 £000	Variance +/- £000
Interest Payable:			
PWLB – Maturity Loans	12,415	12,415	-
PWLB - E.I.P Loans	5,340	5,340	-
Other Long Term Loans	512	510	(2)
HCC Transferred Debt	420	410	(10)
Interest on Finance Lease	220	546	326
Interest on Service Concession Arrangements (including PFIs)	8,763	6,982	(1,781)
Interest Payable to External Organisations	4	1	(3)
Premiums and Discounts on Early Redemption of Debt	31	33	2
	<hr/>	<hr/>	<hr/>
	27,705	26,237	(1,468)
<u>Deduct</u>			
Investment Income:			
Interest on Investments	(5,192)	(5,297)	(105)
Other interest receivable	(1,376)	(1,340)	36
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	21,137	19,600	(1,537)
Provision for Repayment of Debt	6,368	6,628	260
Debt Management Costs	399	360	(39)
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	27,904	26,588	(1,316)

Net treasury management costs were £1.3m below the revised budget mainly due to a reduction in interest payable.

The highways maintenance private finance initiative (PFI) scheme provides for capital works to bring the highway network up to a specified condition (including interest and principal repayments on loans taken out by the contractor), lifecycle replacement (subsequent capital works), and operation and maintenance. This is an inseparable PFI which means that although the Council knows how much it pays the contractor it does not know how the contractor spends its revenues on the various components of the scheme. The revised estimate of the interest on the highways maintenance (PFI) was prepared on the basis of nominal costs in the original financial model prepared at the commencement of the contract in 2004. In preparing the 2016/17 Statement of Accounts it was decided that the estimated indexation used previously may have become less accurate over time and that more accurate estimates may be derived from using actual indexation. This has resulted in the interest on the highways maintenance PFI being £1.8m less than the revised estimate. This does not represent an overall saving to the Council as the overall cost of the highways maintenance PFI is broadly the same with additional expense being charged to highways operation and maintenance, capital expenditure charged to revenue balances to cover lifecycle replacement costs, and principal repayment of debt.

The reduction in interest payable on the highways maintenance PFI was partly offset by an increase in interest payable on under finance leases. The Council has entered into a finance lease for the Isle of Wight ferry terminal to enable it to fulfil its obligations to Wightlink following the disposal of the head lease for this site. The Council has paid £0.3m interest on this finance lease in 2016/17 which was not included in the revised estimate.



DEBT MATURITY PROFILE

