monmouthshire county council
sir fynwy

REPORT

SUBJECT:	**TREASURY HALF YEAR REPORT 2015/16**
MEETING:	**Audit Committee**
DATE:	**22nd October 2015**
DIVISION/WARDS AFFECTED:	**Countywide**

1. PURPOSE:

1.1 The Council's treasury management activity is underpinned by CIPFA's Code of Practice on Treasury Management ("the Code"), which requires local authorities to annually produce Prudential Indicators and a Treasury Management Strategy Statement on their likely financing and investment activity. The Code also recommends that members are informed of treasury management activities at least twice a year. The Head of Finance, as S151 Officer, reports twice a year (mid-year and after the year-end) on Treasury activity to the Audit Committee who provide scrutiny of treasury policy, strategy and activity on behalf of the Council.

2. RECOMMENDATIONS:

2.1 That Members note the results of treasury management activities during the first half of 2015-16.

3. KEY ISSUES:

3.1 In summary many of the longer term key aspects remains as per the 2014-15 outturn as the Council has not arranged any new long term borrowing and continues to make short term borrowing and lending decisions. For ease of reference, the 2014-15 outturn position was,

Capital Financing Requirement	£122.9million	
Funded by External Loans		
Short Term	£32.8 million	Avg rate 0.46%
Long Term	£66.5 million	Avg rate 4.74%
Sub Total	£99.3 million	Increase of £1.4 million on 2013-14 outturn

		Average interest rate of 3.45%, improvement of 0.2% on previous year profile
Other Long term Liabilities	£1.2 million	PFI and finance lease obligations, plus contractor bonds and deposits
Total Debt	£100.5 million	
Investments		
Short Term	(£12.2 million)	Increase of £1.3 million on 2013-14 outturn Avg rate 0.44% Avg investment period 25.5 days
Net Investments @ outturn	(£12.2 million)	

3.2 In comparison, the short term borrowing and investment balances as at end of September 2015 were,

Investments	£20.3 million at an average return of 0.44%
Short term loans	£25 million at an average interest rate of 0.47%

This approach evidences very little cost of carry.

3.3 Members may also benefit from a refresher about the Council's situation with regard to Lender's Option Borrower's Option loans, or LOBOs as they are commonly called, which have been made newsworthy over this last 6 months, with television programmes and articles referring to them as being "high risk".

The Council has 3 LOBO loans totaling £13.6m. These loans were taken out as part of a measured and prudent Treasury management strategy, and weren't significantly dissimilar to long term fixed rates available at the time. Consequently they carried little risk. Any prudent treasury strategy involves splitting the overall requirement between variable and fixed rate instruments so that the interest rate exposure risk is spread. To put it simply, we'd wish to avoid putting all our eggs in one basket.

News reports can suggest that : "interest rates can rise higher and higher and leave the council 'locked in' for a long period of time. LOBO rates can be regarded as semi-fixed borrowing, and the reality is that while the lender has the opportunity to propose a rate change, the council doesn't need to accept it. Instead, we can repay and arrange alternate financing, this would likely be the course of action given current market conditions.

Ironically, if we wished to redeem a similar fixed term facility from 10 years ago, the council would likely pay a premium on repayment, so in that regard LOBO's could be regarded as providing a greater flexibility and opportunity to restructure at a more economic cost than equivalent fixed term instruments - whilst having reduced interest rate exposure risk compared to a completely variable rate facility.

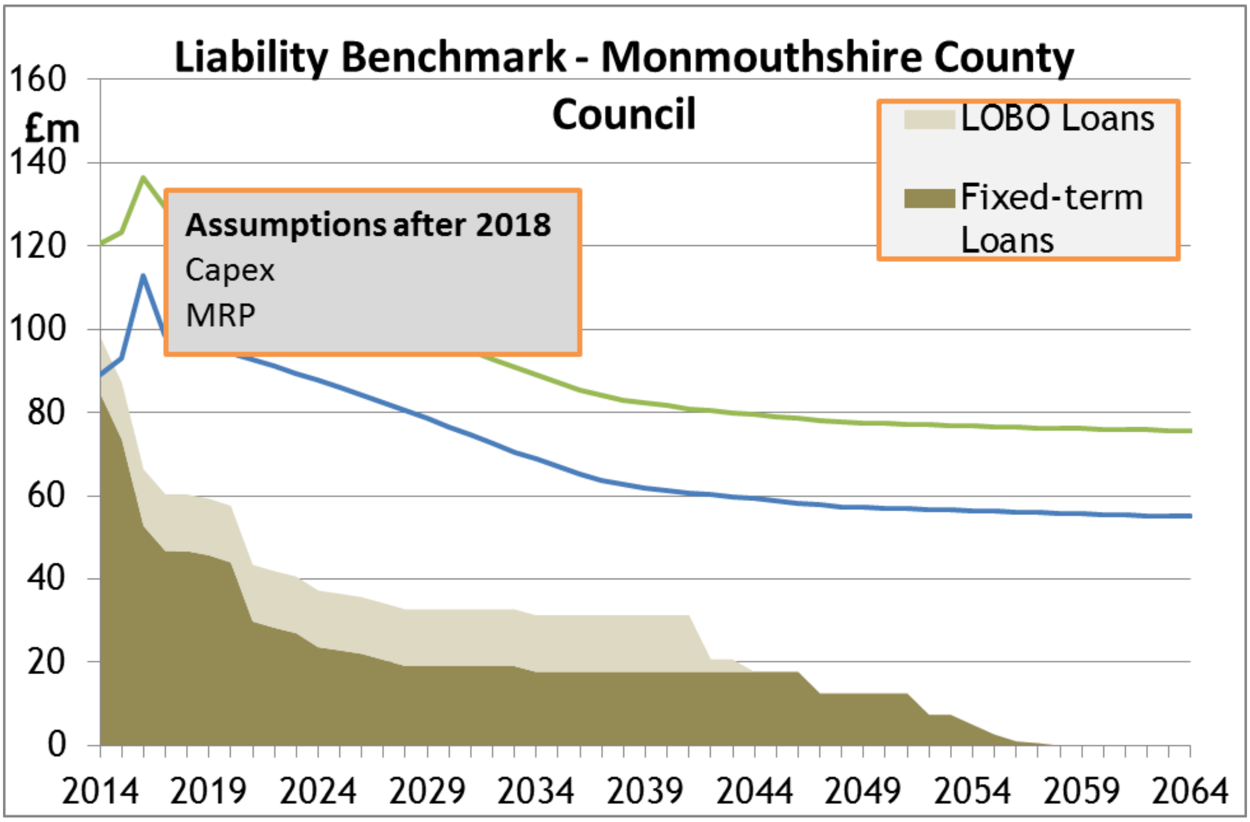
In short, please be reassured that MCC's limited LOBO loan portfolio does not constitute a high risk approach for this council.

3.3 Market Conditions

3.3.1 Monmouthshire continues to minimise the amount of external borrowing by taking advantage of reserves and capital receipts balances (internal borrowing). This did result at outturn in lower investment balances (£12.2.8m) of more of a short term nature but is a very cost effective treasury strategy given cost of borrowing that is avoided. This strategy has continued during 2015-16. The investment levels are higher at the moment but this is commonplace for this time of year and it is usual to see variable levels of investment and borrowing on a daily basis with a short term approach to managing a largely neutral cashflow position.

3.3.2 The Welsh Government's Guidance on Investments, effective from 1st April 2010, reiterated security and liquidity as the primary objectives of a prudent investment policy before yield. The Authority's strategy has always adopted a risk averse approach which compliments this guidance.

3.3.3 The UK Bank Rate continues to remain at 0.5% and has been this way since 2009 and money market rates remain at historic lows. Combined with a trend in deterioration in counterparty credit quality, this has had a significant impact on investment income, but low bank base rates also serves to keep short term borrowing costs depressed, to the extent that our cost of carry is negligible concerning short term cashflows. Treasury consultants suggest that we will likely start to see rate rises in 2016-17, which is likely to accord with our net need to increase borrowing as indicated in the following graph from 2015-16 Strategy document, and may prudently involve decisions to borrow a greater extent longer term again.



3.4 Prudential Indicators and Treasury Management Indicators

3.4.1 The Authority has operated within the set prudential indicators, as outlined in the Treasury Management Strategy approved by Council for the year. The more evidential ones include,

Operational Boundary for External Debt

	2013/14 Actual £000	2014/15 Estimate £000	2015/16 Estimate £000	2016/17 Estimate £000	2017/18 Estimate £000	2018/19 Estimate £000
Borrowing	99.9	99.0	120.2	120.4	116.2	119.7

Other long term liabilities	1.3	1.2	1.1	1.1	1.1	1.0
	101.2	**100.2**	**121.3**	**121.5**	**117.3**	**120.7**

Ratio of financing costs to net revenue stream

Estimates of the ratio of financing costs to net revenue stream for the current and future years, are:

	2013/14 Actual %	**2014/15 Estimate %**	**2015/16 Estimate %**	**2016/17 Estimate %**	**2017/18 Estimate %**	**2018/19 Estimate %**
Ratio of financing costs to net revenue stream	5.79	6.47	6.33	6.50	7.00	7.07

3.4.2 All investments made during the year have complied with this agreed Treasury Management Strategy. Maturing investments were repaid to the Council in full and in a timely manner. Counterparty credit quality has been maintained through the period, despite declining credit ratings, and the need to mitigate the risks associated with potential bank "bail ins".

3.4.3 Unusually there has been one deficiency evident during the period which requires reporting, and that involved having £4.8 million with one counterparty which breached agreed Treasury Strategy limits. This occurred on 18th August when the Council's banking team unfortunately didn't make the instructed investment deposits to the Debt Management Office of £1million overnight and £3m for 2 days, and the Police precept payment of £786,000. This resulted in the Council's bank account holding surplus cash overnight. The oversight was corrected and payments made the following day. Subsequent review indicated a simple miscommunication where one member of the team thought another was arranging it. This weakness has been tightened up subsequently.

3.4.4 **Minimum Revenue provision**

Alongside consideration and agreement of the annual Treasury Strategy, members also consider the minimum revenue provision approach. Officers are currently reviewing the present approach, and are intent to bring a separate paper to members shortly to consider some refinements in approach designed to alter the profile of costs.

4. REASONS:

4.1 The Authority's Treasury Management Strategy has been underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2011.

4.2 The code includes the requirement for determining a treasury strategy on the likely financing and investment activity for each financial year.

4.3 The Code also recommends that members are informed of Treasury Management activities at least twice a year. This report therefore ensures this authority is embracing Best Practice in accordance with CIPFA's recommendations.

5. RESOURCE IMPLICATIONS:

The borrowing and investment activity is broadly neutral at the moment, and in accord with Treasury strategy guidelines and related budgets. There are no other resource implications arising directly from this report.

6. EQUALITY AND SUSTAINABLE DEVELOPMENT IMPLICATIONS: None

7. CORPORATE PARENTING IMPLICATIONS: None

8. CONSULTEES: Technical performance report on matters of fact. No consultation necessary

9. BACKGROUND PAPERS: None

10. AUTHOR:

Mark Howcroft Assistant Head of Finance

11. CONTACT DETAILS:

Tel. 01633 644740
e-mail: markhowcroft@monmouthshire.gov.uk