Report To:	**OVERVIEW (AUDIT) PANEL**
Date:	12 September 2016
Executive Member/Reporting Officer:	Cllr Jim Fitzpatrick – First Deputy (Finance and Performance) Ian Duncan – Assistant Executive Director, Finance (Section 151 Officer)
Subject:	**TREASURY MANAGEMENT ACTIVITIES**
Report Summary:	The report sets out the Treasury Management activities for the financial year 2015/16. It also provides initial commentary on the impact of the recent Referendum for treasury management activities. As investment interest rates were lower than external borrowing rates throughout the year, available cash reserves were used to fund internal borrowing on a temporary basis. This resulted in lower than anticipated borrowing costs, with an external interest saving of £5.981m. Investment returns were £0.009m higher than estimated.
Recommendations:	1. That the treasury management activities undertaken on behalf of both Tameside MBC and the Greater Manchester Metropolitan Debt Administration Fund (GMMDAF) are noted. 2. The outturn position for the prudential indicators in **Appendix A** are approved. 3. The early and emerging implications for treasury management of the recent Referendum are noted.
Links to Community Strategy:	The Treasury Management function of the Council underpins the ability to finance the Council's priorities.
Policy Implications:	In line with Council Policies.
Financial Implications: (Authorised by the Section 151 Officer)	By not taking up the borrowing requirement since 2009/10, a saving on external interest payments of £5.986m was achieved against the 2015/16 original estimate. The investment returns for 2015/16 were £0.009m higher than the original estimate. The outcome of the treasury management actions shown above, resulted in net external interest during 2015/16 of £4.984m, being a saving of £5.981m compared to the original estimate.
Legal Implications: (Authorised by the Borough Solicitor)	The report complies with the Council's financial regulation 17.3. The Council is required by statute to set and maintain a balanced budget, careful management of the finances allows the Council to achieve this and this report provides a means for Members to monitor the situation.
Risk Management:	Failure to properly manage and monitor the Council's loans and investments could lead to service failure and loss of public confidence.
Access to Information:	The background papers relating to this report can be inspected

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1. INTRODUCTION

1.1 This is the Annual Report on Treasury Management for the financial year 2015/16. The report is required to be submitted to the Overview (Audit) Panel prior to 30 September 2016, in accordance with CIPFA's Code of Practice on Treasury Management, the Council's Financial Regulations and the CIPFA Prudential Code.

1.2 The report is in respect of both Tameside and the Greater Manchester Metropolitan Debt Administration Fund (GMMDAF), which is the former Greater Manchester County Council Debt of which Tameside is the responsible Authority on behalf of the ten Greater Manchester Councils.

The objective of the report is:

a) To outline how the treasury function was managed during the year and how this compares to the agreed strategy.
b) To set out the transactions made in the year;
c) To summarise the positions with regard to loans and investments at 31 March 2016; and
d) To set out the outturn position of the Council's prudential indicators.

2. TREASURY MANAGEMENT

2.1 Treasury Management is defined as:
"The management of the local authority's cash flows, its borrowings and its investments, the management of associated risks, and the pursuit of the optimum performance or return associated with these risks".

2.2 Within this definition, the Council has traditionally operated a relatively low risk strategy. This in effect means that controls and strategy are designed to ensure that borrowing costs are kept reasonably low over the longer term, rather than subject to volatility that a high risk strategy might deliver. Where investments are involved, the policy is to ensure the security of the asset rather than pursue the highest returns available. These objectives are in line with the Code of Practice.

2.3 The global financial crisis has raised the overall possibility of default. The Council continues to maintain strict credit criteria for investment counterparties to manage this risk. A system of counterparty selection was agreed by the Council as part of the budget setting process.

3. DEBT

3.1 The long-term debt of the Council reflects capital expenditure financed by loans, which are yet to be repaid.

3.2 The amount of long-term debt that the Council may have is governed by the Prudential Limits set by the Council at the start of the financial year. This is based on the amount of borrowing which the Council has deemed to be prudent. It also allows for advance borrowing for future years' capital expenditure.

3.3 The Council must also allow for repayment of the debt, by way of the Minimum Revenue Provision (MRP). This is the minimum amount that the Council must set aside annually. The Local Authority (Capital Finance and Accounting) Regulations 2008 revised the previous detailed regulations and introduced a duty that an authority calculates an amount of MRP which it considered prudent, although the 2008 Regulations do not define "prudent provision", they provide guidance to authorities on how they should interpret this.

3.4 In 2015/16 the Council's MRP policy was revised from the previous practice (4% of the capital finance requirement on a reducing balance basis) to a straight line method of 2% of the 2015/16 capital financing requirement over a period of 50 years.

3.5 Any new prudential borrowing taken up will be provided for within the MRP calculation based upon the expected useful life of the asset or by an alternative approach deemed appropriate to the expenditure in question.

3.6 For any finance leases and any on-balance sheet public finance initiative (PFI) schemes, the MRP charge will be equal to the principal repayment during the year, calculated in accordance with proper practices.

3.7 There will be no MRP charge for any cash backed Local Authority Mortgage Scheme (LAMS) that the Council operates. As for this type of scheme, any future debt liability would be met from the capital receipt arising from the deposit maturing after a 5 year period. Any repossession losses for this type of scheme would be charged to a LAMS reserve.

3.8 The majority of the Council's debt has been borrowed from the Public Works Loan Board (PWLB), and is solely made up of long term fixed interest loans. In previous years use has also been made of loans from banks. The main type of loan used is called a LOBO (Lender's Option - Borrower's Option) where after a pre-set time the lending bank has the option of changing the original interest rate. These loans are classified as variable interest rate loans when they reach option date. If we do not agree with the new interest rate, we have the option of repaying the loan. One of the Council's LOBO providers, Barclays, has recently confirmed that they are planning to waive their right to change the rate on their LOBO. This will essentially convert that loan into a standard fixed rate loan with no risk of any increase in rate.

3.9 The mixture of fixed and variable rates means that, although the Council can take some advantage when base rates are considered attractive, interest charges are not subject to high volatility which might occur if all debt was variable. However, longer term fixed rates are normally higher than variable rates.

3.10 Short term borrowing and lending are used to support cash flow fluctuations caused by uneven income and expenditure, and to temporarily finance capital expenditure when long term rates are high and expected to fall. It is an extremely important aspect of Treasury Management to ensure that funds are available to meet the Council's commitments, and that temporary surplus funds attract the best available rates of interest.

4. INTEREST RATES

4.1 Interest rates (both long term and short term) vary constantly, even though headline rates (e.g. base rate, mortgage rate) may remain the same for months at a time.

4.2 In addition, different banks may pay different rates depending on their need for funds, and more particularly their credit status. Rates for borrowing are significantly higher than lending for the same period.

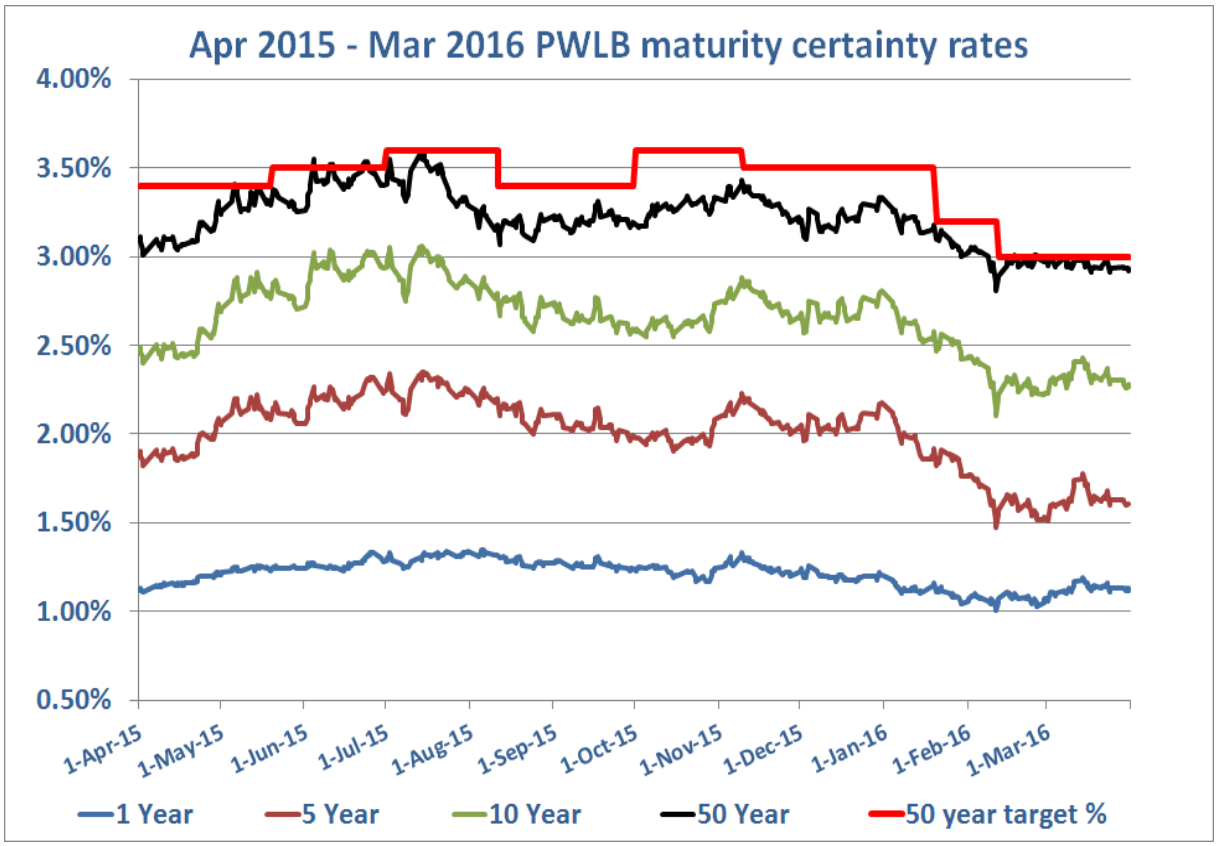
4.3 Long term interest rates are based on Government securities (Gilts), which are potentially volatile with rates changing every day, throughout the day. PWLB fixed loan rates are changed on a daily basis. In view of this, gilts and all matters which affect their prices are continually reviewed.

4.4 Following the Comprehensive Spending Review in October 2010, the PWLB increased the borrowing rates above gilt rates by a further 0.75 – 0.85% without changing debt redemption interest rates. However, the PWLB continues to offer a scheme to allow a 0.20% reduction on published borrowing rates known as the "certainty rate", for Councils that provide indicative borrowing requirements for the next 3 years. The Council has provided this information and has therefore protected its eligibility for the "certainty rate". This does not however commit the Council to a particular course of action.

4.5 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.

4.6 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.

4.7 The table shown below (published by Capita) shows the comparative Public Works Loan Board interest rates available during 2015/16, for a range of maturity periods.



5. ACTIVITIES 2015/16

Borrowing

5.1 The Council originally had a potential borrowing requirement for the year of £82.332 million.

5.2 The actual amount of long term borrowing which was required due to Council activity was £68.931 million as outlined below: -

	£ millions
Loan financed capital expenditure:	
outstanding for 2015/16	7.742
outstanding for 2014/15	1.429
outstanding for 2013/14	11.845
outstanding for 2012/13	0.908
outstanding for 2011/12	(2.038)
outstanding for 2010/11	12.734
outstanding for 2009/10	29.650
outstanding for 2008/09	0.331
Plus debt maturing in year	10.034
	72.635
Less MRP repayments (excluding PFI)	**(3.704)**
Net under borrowed position	**68.931**

5.3 Due to the unfavourable differences between borrowing rates and investment rates and also to reduce the risk to the Council from investment security concerns, the borrowing requirement of £68.931million identified above, continues to be met from internal borrowing (i.e. reducing the cash balances of the Council rather than taking up additional external borrowing). This has reduced the level of investment balances that would be placed with banks and financial institutions, therefore reducing the Council's exposure to credit risk.

5.4 The outstanding borrowing requirement of £68.931million will be taken up when both interest rates and investment security are deemed to be favourable, in consultation with the Council's treasury management advisors, Capita.

Rescheduling

5.5 Rescheduling involves the early repayment and re-borrowing of longer term PWLB loans, or converting fixed rate loans to variable and vice versa. This can involve paying a premium or receiving a discount, but is intended to reduce the overall interest burden, since the replacement loan (or reduction of investment) is normally borrowed at a lower interest rate.

5.6 The use of rescheduling is a valuable tool for the Council, but its success depends on the frequent movement of interest rates, and therefore it cannot be estimated for. It will continue to be used when suitable opportunities arise, in consultation with our treasury management advisors, although such opportunities may not occur.

5.7 A key change in the options for borrowing and rescheduling occurred on 1 November 2007 when the PWLB changed its interest rate structure to a more sensitive pricing method and also increased the relative cost of repaying debt. This change has reduced the ability of the Council to achieve savings from the rescheduling of debt.

5.8 As mentioned above, in October 2010 the PWLB increased the borrowing rates above gilt rates by a further 0.75% – 0.85% without changing debt redemption interest rates. This change has made new borrowing more expensive and reduced the opportunities for PWLB debt re-scheduling.

5.9 The Section 151 Officer and our treasury management advisors will continue to monitor prevailing rates for any opportunities to reschedule debt during the year.

Year end position

5.10 The following table sets out the position of the Council's debt at 1 April 2015, the net movement for the year, and the final position at 31 March 2016.

Principal Amounts	Debt O/S 01/04/15 £000's	Debt Repaid £000's	Loans / Investments In year £000's	Debt O/S 31/03/16 £000's
PWLB - fixed interest	87,500	(10,305)		77,195
PWLB - variable interest	0			0
Market Loans	40,000			40,000
* Manchester Airport	3,103	(713)		2,390
Temp Loans / (Investments)	(146,899)		(16,860)	(163,759)
Trust Funds, Contractor Deposits etc	121	11		132
Net loans outstanding	**(16,175)**	**(11,007)**	**(16,860)**	**(44,042)**

5.11 The amount of gross external loans outstanding (£119.6m) represents 21% of the Council's total long term assets (£566.7m) as at the 31 March 2016.

5.12 In addition, the Council temporarily utilised internal funds, balances and reserves including Insurance Funds and capital reserves, to finance capital expenditure rather than borrow externally.

** Manchester Airport reflects debt taken over from Manchester City Council on 31 March 1994. In 2009/10 the Airport re-negotiated the terms of this arrangement with the 10 Greater Manchester Authorities, previously the Airport reimbursed all costs, however from 9 February 2010 the Council receives fixed annual interest of 12% of the amount outstanding at that date with a repayment of the debt by 2055.*

Investments – managing cash flow

5.13 Short term cash flow activity was such that throughout the year the Council was always in a positive investment position. Since interest earned on credit balances with our own bankers is low and overdraft rates are high, investment and borrowing is carried out through the London Money Markets. The Council invests large sums of money, which helps ensure the interest rates earned are competitive.

5.14 The Local Government Act 2003 governs investments made by local authorities. The types of investments that may be made are controlled by guidance from the Department for Communities and Local Government. This guidance has split investments into two main categories – specified and non-specified investments.

5.15 Specified investments consist mainly of deposits with very highly rated financial institutions and other local authorities for periods of less than one year. The Council's approved "Annual Investment Strategy" for 2015/16 stated that at least 75% of our investments would be "specified".

5.16 The high credit ratings chosen by the Council were a minimum of A+ long term and F1 short term ensures the security of the investment is the main priority. In the Council's mid-year Treasury Management Report approval was given to extend the Council's counterparty list to mirror that of the Council's advisors, Capita. This allowed access to an increased range of counterparties and therefore improved levels of diversification and yield. The Capita Asset Services' creditworthiness service uses a wider array of information than just primary ratings. Furthermore, by using a risk weighted scoring system, it does not give undue preponderance to just one agency's ratings. Typically the minimum credit ratings criteria the Council use will be a Short Term rating (Fitch or equivalents) of F1 and a Long Term rating of A-.

5.17 All investments placed in the year agreed with the approved strategy. Within this lower risk strategy, the aim is to maximise the rate of return for the investments. In order to gauge whether the performance is satisfactory, it is necessary to compare it with a suitable benchmark. The normal benchmarks used to measure market rates are 7 day London Interbank Offer Rate (LIBOR) for loans, and 7 day London Interbank Bid Rate (LIBID) for investments. The actual returns for loans and investments were therefore measured against the theoretical performance of the above rates, using actual cash flow figures.

5.18 Tameside achieved an average investment rate of 0.47% on the average weekly investment, against a benchmark LIBID rate of 0.36%. This equated to a gain of £171,138. Gains, such as this, can only be made by strategic investment, where interest rates do not follow the general "market" expectations. In effect, some investments were made for longer durations, attracting higher interest rates, while the shorter dated rates did not increase in line with market pricing.

5.19 The annual turnover for investments was £510m.

5.20 No short term loans were required to aid cash-flow during the year, due to investments being placed with a short maturity profile.

Interest payable and receivable in the year

5.21 As detailed above, the £68.931m outstanding borrowing requirement has been met from internal borrowing during the year. This has reduced the level of investment balances placed with banks and financial institutions.

5.22 The full year impact of the decision not to take up this borrowing requirement has been to reduce external interest payable by £5.986m. The interest received on investment balances has been £0.009m higher than estimated.

5.23 The overall result of the various activities undertaken during the year was that net external interest charge was £5.981m less than the original estimate.

5.24 Interest payments associated with the above activities were:-

	Original Estimate £m	Actual £m	Variation £m
External Interest			
Paid on Loans etc	11.906	5.920	(5.986)
Early repayment Discounts	(0.205)	(0.191)	0.014
Less received on Investments	(0.736)	(0.745)	(0.009)
Net external Interest paid	**10.965**	**4.984**	**(5.981)**
Internal Interest Paid	0.117	0.113	(0.004)

Total Interest Paid	11.082	5.097	(5.985)

5.25 Accounting rules do not allow interest to be paid on internal funds and revenue balances. Payments however are made in respect of such funds as insurance and trust funds etc. held by the Council on behalf of external bodies. The net effect on the Council is neutral.

6. CURRENT ACTIVITIES

6.1 Since the start of the 2016/17 financial year, no new rescheduling opportunities have been identified. The portfolio of loans held by the Council is reviewed on a regular basis by both the Treasury Management Section and by the Council's treasury management advisors (Capita).

6.2 In 2016/17, in order to achieve greater diversification, the Council will give consideration to the use of those suitable foreign banks that meet the strict credit criteria as set out in the Treasury Management Strategy, should the rates offered be competitive.

6.3 The Council operates a Local Authority Mortgage Scheme to help first time buyers in the area, this involves the Council placing a deposit of £1m with Lloyds Bank for 5 years. This deposit is deemed to be a policy investment, rather than a treasury management investment and as such is separate to the above criteria.

7. UPDATE – EU REFERENDUM

7.1 The most significant event of the current financial year has been the decision on 23 June by the UK to negotiate an exit from the European Union (EU), which is expected to have significant implications for financial assets, economies and currencies.

7.2 At the time of writing this report the markets are taking time to settle in the aftermath of the unexpected referendum result. Sterling deposit levels have eased on the expectation that rates will remain lower for longer than previously expected, as the uncertainty over the future of the UK economy will linger for some considerable time. Meanwhile, negotiations over the EU exit are set to commence later than initially expected, and last a further two years after they start. As things stand, even with a new Prime Minister in place, the expiry of the negotiation period would be October 2018. The interim instability throws up the prospect of the Bank of England having to offer further support to the economy. The Bank has already intervened to put a brake on the Sterling crash on the foreign exchange markets and interest rates have been cut. Negative interest rates are an unlikely outcome, as the Bank would probably opt to increase Quantitative Easing ahead of such action. Cuts to interest rates could have a direct impact on the Council by lowering the rate of return available on its investments.

7.3 Another immediate consequence has been a surge in purchasing of gilts due to their status as "safe haven" assets in a period of uncertainty. This surge of purchasing has lowered gilt yields by as much as 45 basis points. As discussed earlier in this report, the Council has the ability to borrow from the PWLB, which sets its rates based on gilts. The fall in gilt yields has therefore led to a subsequent fall in PWLB rates, meaning that the Council has access to borrowing at lower rates. The Council will continue to closely monitor these rates and take up borrowing if considered beneficial in the long term.

7.4 The ratings agencies have reacted to the referendum by downgrading the UK's sovereign rating and placing it on a negative outlook. The agencies are yet to downgrade any individual banks, although some have been placed on a negative outlook by Moody's. The Capita Creditworthiness List used by the Council takes ratings into account, so any

significant downgrades could have the impact of limiting the range of counterparties available to the Council, which in turn could reduce the yield from our investments.

7.5 Capita has reassured the Council that whilst there are negative implications for the UK, its economy and financial institutions as a result of the referendum, financial markets and the operators therein are materially stronger in terms of capital and liquidity than they were ahead of the financial crisis. Furthermore, Mark Carney, Governor of the Bank of England, stated in the immediate aftermath of the vote that "…the capital requirements of our largest banks are now ten times higher than before the crisis. The Bank of England has stress tested them against scenarios more severe than the country currently faces. As a result of these actions, UK banks have raised over £130bn of capital, and now have more than £600bn of high quality liquid assets."

7.6 The Council's Treasury Management team will maintain a watching brief of this changing situation and is aided in this with regular advice and updates from Capita, along with brokers and market professionals. Capita's "Passport" system also provides the team with direct access to ratings agency changes along with PWLB and market rates.

8. GMMDAF ACTIVITIES

8.1 The GMMDAF incurs no capital expenditure and therefore the total debt outstanding reduces annually by the amount of debt repaid by the constituent authorities. However, further loans are taken out to replace loans that mature during the year. In addition, short term loans and investments are required to optimise the cashflow position, due to the difference in timing between receiving payments from the ten district councils and making loan and interest payments to the PWLB etc. Like the Council, rescheduling opportunities are taken if the right conditions exist.

8.2 During 2015/16 the debt outstanding reduced by £14.080m. The debt will be fully repaid by 31 March 2022.

8.3 The following table sets out the position at 1 April 2015, the net repayments and the final position at 31 March 2016.

Principal Amounts	Debt O/S 01/04/15 £000's	Debt Maturing £000s	New Loans/ Investments £000s	Debt O/S 31/03/16 £000s
PWLB	121,926	(22,000)	0	99,926
Pre 1974 Transferred Debt	270	(32)	0	238
Temp Loans / (Investments)	923	0	7,022	7,945
Other Balances	1,743	0	930	2,673
	124,862	**(22,032)**	**7,952**	**110,782**

8.4 No long term borrowing was required for 2015/16. The timing of any future borrowing will be carried out in consultation with our treasury management advisors, when interest rates are deemed favourable.

8.5 Although the portfolio of loans held by the Fund is reviewed on a regular basis by both Treasury Management officers and by the Council's treasury management advisors (Capita), no rescheduling opportunities were identified in 2015/16. Rescheduling will continue to be used when suitable opportunities arise, however long term borrowing is restricted by the end date of the Fund (2022), which has meant that it is difficult to reschedule debt in the present interest rate yield curve.

8.6 During the year, the fund made overall interest payments of £6.458m. This equated to an average "pool rate" of 5.26%, against the original estimate of 5.33%, and compares with 5.73% in 2015/16.

8.7 Manchester Airport re-negotiated the terms of its loan arrangement with the 10 Greater Manchester Councils in 2009/10. As a result of this arrangement the 10 Councils took responsibility to service the former Manchester Airport share of the GMMDAF. Previously, the debt was serviced by the airport itself.

9. PRUDENTIAL LIMITS

9.1 At the start of the financial year the Council sets Prudential Indicators and limits in respect of Capital expenditure and borrowing. The outturn position for the Prudential Indicators are shown at **Appendix A**. Prudential indicators do not provide an effective comparative tool between Local Authorities, and therefore should not be used for this purpose.

10. RECOMMENDATIONS

10.1 As stated on the report cover

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APPENDIX A

Prudential Indicators – Actual outturn 2015/16

Indicator	**Limit**	**Actual Outturn**
Ratio of financing costs to net revenue stream	8%	4%
Capital financing requirement	£211.163	£181.511m
Capital expenditure in year	£53.763m	£39.997m
Incremental impact on capital investment decisions	£8	£3
Authorised limit for external debt	£257.319m	£127.085m
Operational boundary for external debt	£237.319m	£127.085m
Upper limit for fixed interest rate exposure	£211.163m	(£11.421m)
Upper limit for variable interest rate exposure	£63.349m	(£17.900m)
Upper limit for total principal sums invested for over 364 days	£30m	£0m

Maturity structure for fixed rate borrowing

Indicator	Limit	Outturn
Under 12 months	0% to 15%	0.92%
12 months and within 24 months	0% to 15%	5.41%
24 months and within 5 years	0% to 30%	0.84%
5 years and within 10 years	0% to 40%	4.17%
10 years and above	50% to 100%	88.66%