

THE BORROWING REQUIREMENT AND DEBT MANAGEMENT

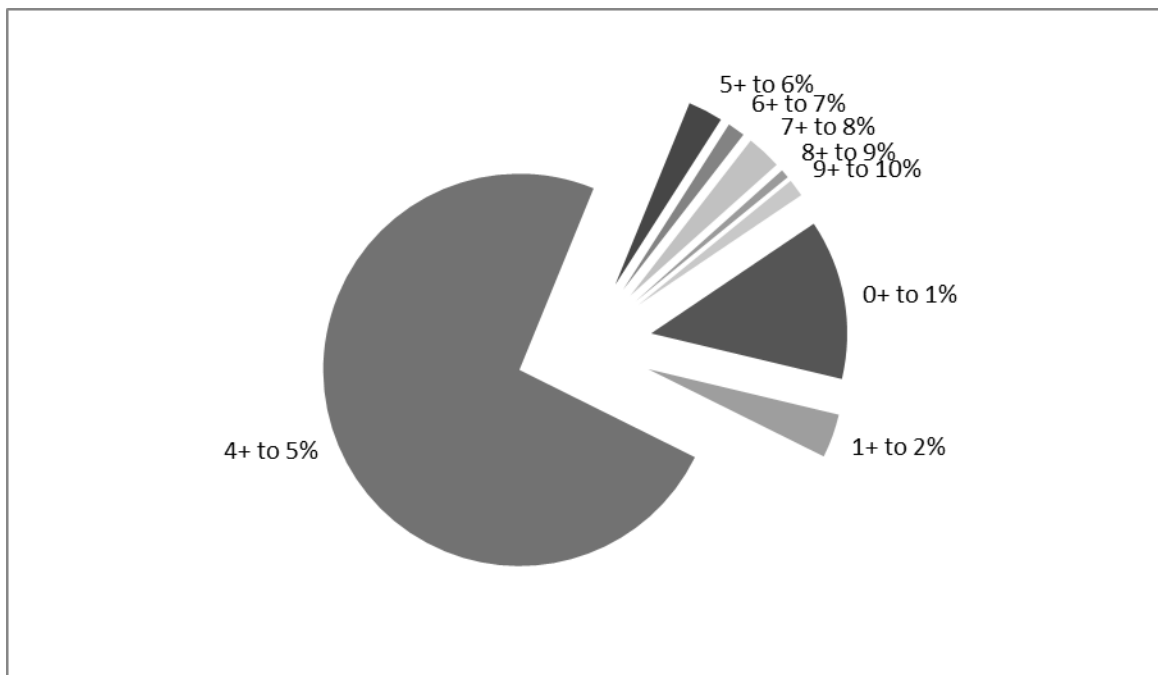
	Balance on 01/04/2014 £m	Maturing Debt £m	Debt Prematurely Repaid £m	New Borrowing £m	Balance on 31/03/2015 £m	Ave. Rate % and Ave. Life (yrs)
CFR	227.5				246.8	
Short Term Borrowing ¹	31.0	(39.8)	0.0	27.1	18.3	0.47% 0.07 years
Long Term Borrowing ²	121.9	(1.5)	0.0	0.0	120.4	4.96% 8.97 years
TOTAL BORROWING	152.9	(41.3)	0.0	27.1	138.7	4.37% 8.29 years
Other Long Term Liabilities	27.5				50.8	
TOTAL EXTERNAL DEBT	180.4				189.5	
Increase/ (Decrease) in Borrowing £m					(14.2)	

1. The council's underlying need to borrow as measured by the Capital Financing Requirement (CFR) at 31 March 2015 was £246.8 million. Usable reserves and working capital, which are the internal resources available for investment, were £52.2 million at 31 March 2015.
2. The council's chief objective when borrowing money has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required. The flexibility to renegotiate loans should the council's long-term plans change is a secondary objective.
3. Given the significant cuts to public expenditure and in particular to local government funding, the council's borrowing strategy continued to address the key issue of affordability without compromising the longer-term stability of the debt portfolio.
4. At 31 March 2015, the council held £138.7 million of loans, a decrease of £14.2 million on the previous year, as part of its strategy for funding previous years' capital programmes.

¹ Loans with maturities less than 1 year.

² Loans with maturities great than 1 year

5. With short-term interest rates having remained much lower than long-term rates, it continued to be more cost effective in the short-term to use internal resources and borrow short-term loans from the market, mainly from other local authorities. By doing so, the council was able to reduce net borrowing costs despite foregone investment income and reduced overall treasury risk. Whilst such a strategy is most likely to be beneficial over the next 1-2 years as official interest rates remain low, it is unlikely to be sustained in the medium-term.
6. Temporary and short-dated loans borrowed from the markets, predominantly from other local authorities, has remained affordable and attractive. £27.1 million of such loans were borrowed at an average rate of 0.48 per cent and an average life of 53 days, which includes the replacement of maturing loans.
7. The spread of interest rates on all external borrowing outstanding at 31 March 2015 is shown in the graph below:



8. In comparison to other local authorities who participate in the CIPFA Treasury Management benchmarking group, the council's annual average cost of total external borrowing was 0.10 per cent above the universe average (24 other LAs).

Annual Average Borrowing

	Authority			Group Total		
	Av. Balance £'m	Interest £'k	Rate	Av. Balance £'m	Interest £'k	Average Rate
Short-term variable rate	0.0	0.0	na	47	281	0.72%
Long-term variable rate	0.0	0.0	na	0	0	na
Short-term fixed	25.9	146.9	0.57%	169	734	0.58%
Long-term fixed	116.2	5,779.1	4.97%	4,861	210,708	4.38%
LOBO	5.0	212.9	4.26%	1,880	84,145	4.58%
Total	147.1	6,139.0	4.17%	6,957	295,868	4.07%

INVESTMENT ACTIVITY

9. Both the CIPFA and the CLG's Investment Guidance require the council to invest prudently and have regard to the security and liquidity of investments before seeking the optimum yield.

Investment Counterparty	Balance on 01/04/2014 £m	Investments Made £m	Maturities/ Investments Sold £m	Balance on 31/03/2015 £m	Ave. Rate % and Ave. Life (yrs)
UK Central Government	-	62.5	(62.5)	-	
- Short-term	-	-	-	-	
- Long-term	-	-	-	-	
UK Local Authorities					
- Short-term	1.4	34.8	(33.1)	3.1	0.52% 0.28 yrs
- Long-term	-	-	-	-	
Banks and building societies and other organisations					
- Short-term	1.4	136.1	(136.8)	0.7	0.80% 0.00 yrs
- Long-term	-	-	-	-	
Registered Providers of Social Housing	-	-	-	-	
AAA-rated Money Market Funds (MMF)	-	67.3	(67.3)	-	
Other Pooled Funds					
- Other MMF	-	-	-	-	
Bonds issued by Multilateral Development Banks	-	-	-	-	

Investment Counterparty	Balance on 01/04/2014 £m	Investments Made £m	Maturities/Investments Sold £m	Balance on 31/03/2015 £m	Ave. Rate % and Ave. Life (yrs)
Commercial Paper, Corporate Bonds and other marketable instruments	-	-	-	-	
Funds Managed Externally	-	-	-	-	
Loans to small businesses / other organisations	-	-	-	-	
TOTAL INVESTMENTS	2.8	300.7	(299.7)	3.8	0.57% 0.19 yrs
Increase/ (Decrease) in Investments £m				1.0	

10. Security of capital remained the council's main investment objective. This was maintained by following the council's counterparty policy as set out in its Treasury Management Strategy for 2014-15 which defined "high credit quality" organisations as those having a long-term credit rating of A- or higher that are domiciled in the UK.
11. Investments with banks and building societies were primarily call accounts or fixed-rate term deposits. The maximum duration of these investments was 6 months in line with advice provided by Arlingclose Limited.

Credit risk management

12. The council has engaged Arlingclose Limited as its treasury management advisers. Arlingclose provide regular updates on the credit worthiness of UK and overseas banks, as well as sovereign nations and money market funds. Arlingclose also recommend maximum investment duration for each of their approved counterparties. The council has based its investment decisions on this advice throughout the year.
13. Arlingclose provide quarterly analyses of the council's counterparty credit quality. The changes in the council's average counterparty credit score during the year to 31 March 2015 are set out below. Table 2 at the end of this appendix explains the credit score.

Credit Score Analysis 2014-15

Date	Value Weighted Average Credit Risk Score	Value Weighted Average Credit Rating	Time Weighted Average Credit Risk Score	Time Weighted Average Credit Rating
31/03/2014	4.52	A+	5.00	A+
30/06/2014	5.05	A+	5.19	A+
30/09/2014	4.94	A+	4.70	A+
31/12/2014	5.75	A	2.63	AA
31/03/2015	3.25	AA	2.61	AA
Strategy	Max 7.00	Min A-	Max 7.00	Min A-

Liquidity Management

14. In keeping with the CLG's Guidance on Investments, the council maintained a sufficient level of liquidity throughout the year, averaging £9.2 million through the use of call accounts and Money Market Funds. The council uses purpose-built cash flow forecasting software, Logotech Public Sector Treasury Management System, to determine the maximum period for which funds may prudently be committed.
15. The council maintained a short term investment profile over the course of the year. In comparison to other local authorities who participate in the CIPFA Treasury Management benchmarking group (24 other LAs) the council's average investment maturity profile was significantly below the average.

	Overall Weight Average Maturity				
	31-Mar-14	30-Jun-14	30-Sep-14	31-Dec-14	31-Mar-15
Upper Quartile	135.4 days	149.2 days	155.9 days	168.9 days	176.0 days
Group Average	156.7 days	147.5 days	132.3 days	132.0 days	137.6 days
Isle of Wight	3.5 days	54.6 days	6.7 days	51.3 days	77.4 days
Lower Quartile	38.9 days	54.8 days	36.8 days	52.0 days	55.9 days

16. The increased duration of investments compared to 31 March 2014 reflects the decision to undertake longer (but still less than 364 days) lending to the pension fund, to ensure greater certainty of the fund's cash flows.

Yield

17. The UK Bank Rate was maintained at 0.5 per cent through the year. Short term money market rates also remained at very low levels (as shown in table 1 in Appendix C) which continued to have a significant impact on investment income. The average 3-month London Interbank Bid Rate (LIBID) rate during 2014-15 was 0.50 per cent, the 6-month LIBID rate averaged 0.67 per cent and the 1-year LIBID rate averaged 0.95 per cent. The low rates of return on the council's short-dated money market investments reflect prevailing market conditions and the council's objective of optimising returns commensurate with the principles of security and liquidity.
18. The council's budgeted investment income for the year had been estimated at £160 thousand. The average cash balances representing the council's reserves and call accounts working balances were £19.2 million during the period and interest earned was £102.1 thousand.
19. The council continues to lend money to the Isle of Wight Council Pension Fund, to support its operational cash flow requirements. Any lending to the pension fund is undertaken at arm's length, and interest rates charged are based on the current broker rates for the required duration of the loan.
20. During 2014-15, the council had an average daily balance of £1.48 million lent to the pension fund, at an average interest rate of 0.45 per cent. The maximum amount outstanding at any point during the year was £3.3 million, on 28 February 2015.
21. At 31 March 2015, the council had invested (lent to) the pension fund £3.025 million, £1.4 million maturing on 16 October 2015, and £1.625 million maturing on 7 April 2014; it also had £0.72 million invested in an instant access account with Santander UK.
22. In comparison to other local authorities who participate in the CIPFA Treasury Management benchmarking group, the council's annual average interest rate earned on investments was 0.13 per cent below the universe average (24 other LAs).

Annual Average Investment

	Authority			Group Total		
	Av. Balance £'m	Interest £'k	Rate	Av. Balance £'m	Interest £'k	Average Rate
Variable rate	9.2	56.6	0.61%	8,071	14,754	0.60%
Short-term fixed	9.9	45.6	0.46%	1,576	10,590	0.66%
Long-term fixed	0.0	0.0	na	514	6,649	1.45%
Externally Managed	0.0	0.0	na	38	288	0.71%
Total	19.2	102.2	0.53%	10,197	32,281	0.66%

23. It should be noted that the universe average includes corporate deposits, gilts and bonds, of which the council has none.

Compliance

24. The council confirms that it has complied with its **Prudential Indicators** for 2014-15, which were approved on 26 February 2014 as part of the council's Treasury Management Strategy, which can be accessed through the following link:

<https://www.iwight.com/Meetings/committees/mod-council/26-2-14/Paper%20E%20-%20Appendix%205.pdf>

Details of performance against the prudential indicators can be found in Appendix B.

25. In compliance with the requirements of the CIPFA Code of Practice this report provides members with a summary report of the treasury management activity during 2014-15. None of the Prudential Indicators have been breached and a prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.
26. The council also confirms that during 2014-15 it complied with its **Treasury Management Policy Statement** and **Treasury Management Practices**, taking into account the use of a non-specified investment as detailed below:
27. During the period between Christmas 2014 and New Year 2015, when council offices are closed for business, the council deposited £6,025,000 in an instant access account with National Westminster Bank (its main banker) for a period of two days. This was outside the parameters set within the treasury management strategy as follows:
- a. Paragraph 4.1.3.2 states that the council may invest with institutions with a minimum credit rating of A-. At the time of the investment National Westminster Bank had a credit rating of BBB+, and was suspended from the approved investment counterparty list of Arlingclose Limited, the council's treasury management advisers.
 - b. Paragraph 9.1.2 of Schedule 9.1 Approved Investment Counterparties specifies that the council may invest with its current account bank if it fails to meet the minimum credit rating criteria, up to a maximum of £5 million.
28. The decision to invest this sum for this period was discussed with, and approved by, the head of finance and section 151 officer in advance of the Christmas break, taking into account advice sought from Arlingclose.

Table 1: Debt and Investment Portfolio Position 31 March 2015

	31/3/2015 Actual Portfolio £m	31/3/2015 Average Rate %
External Borrowing:		
PWLB – Fixed Rate	110.4	5.21
Local Authorities	23.3	0.62
LOBO Loans	5.0	4.27
Total External Borrowing	138.7	4.41
Other Long Term Liabilities:		
PFI	50.5	
Finance Leases	0.3	
Total Gross External Debt	189.5	
Investments:		
<i>Managed in-house</i>		
Short-term investments	3.8	0.57
Total Investments	3.8	0.57
Net Debt	185.7	

Table 2: Credit Score Analysis

Long-Term Credit Rating	Score
AAA	1
AA+	2
AA	3
AA-	4
A+	5
A	6
A-	7
BBB+	8
BBB	9
BBB-	10

The value weighted average reflects the credit quality of investments according to the size of the deposit. The time weighted average reflects the credit quality of investments according to the maturity of the deposit

The council aimed to achieve a score of 7 or lower, to reflect the council's overriding priority of security of monies invested and the minimum credit rating of threshold of A- for investment counterparties.