

THE BORROWING REQUIREMENT AND DEBT MANAGEMENT

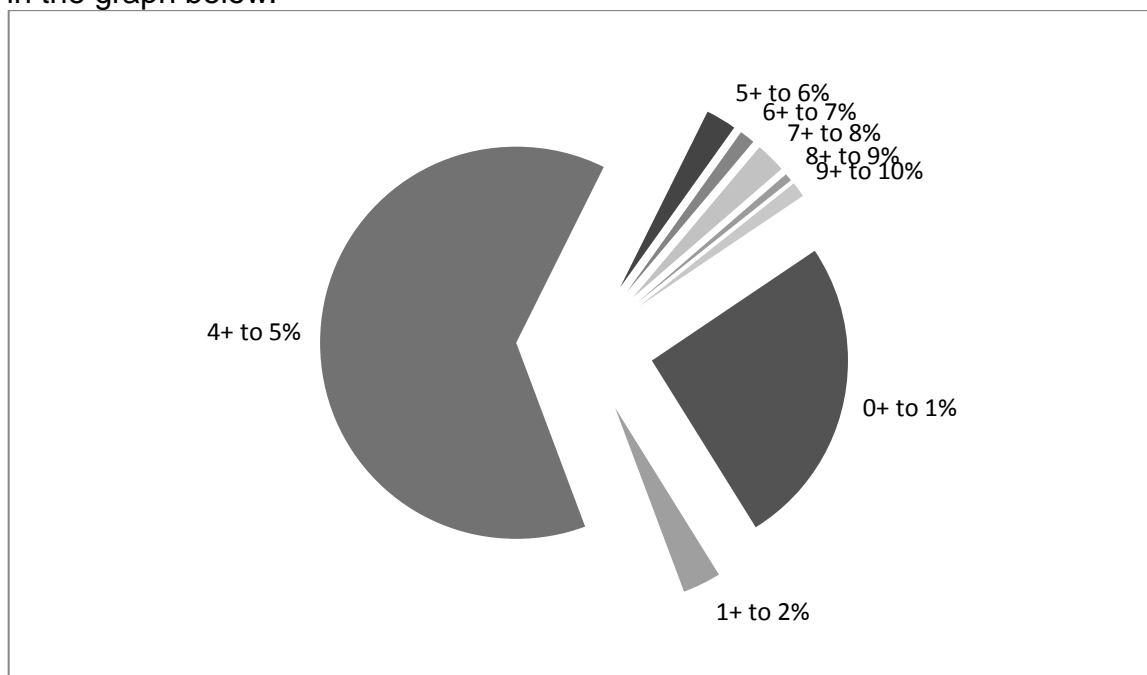
	Balance on 01/04/2015 £m	Maturing Debt £m	Debt Prematurely Repaid £m	New Borrowing £m	Balance on 31/03/2016 £m	Ave. Rate % and Ave. Life (yrs)
CFR	246.8				275.3	
Short Term Borrowing ¹	18.3	(50.2)	0.0	72.4	40.5	0.62% 0.61 years
Long Term Borrowing ²	120.4	(2.5)	0.0	0.0	117.9	4.96% 8.26 years
TOTAL BORROWING	138.7	(52.7)	0.0	72.4	158.4	3.85% 6.94 years
Other Long Term Liabilities	50.8				69.0	
TOTAL EXTERNAL DEBT	189.5				227.4	
Increase/ (Decrease) in Borrowing £m					19.7	

1. The council's underlying need to borrow as measured by the Capital Financing Requirement (CFR) at 31 March 2016 was £275.3 million. Usable reserves and working capital, which are the internal resources available for investment, were £70.9 million at 31 March 2016.
2. The council's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs 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 2016, the council held £158.4 million of loans, an increase of £19.7 million on the previous year, as part of its strategy for funding previous years' capital programmes.
5. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead. By doing so, the council was able to reduce net borrowing costs despite foregoing investment income and reduced overall treasury risk. Whilst such a strategy is most likely to be beneficial over the next 2-3 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, remained affordable and attractive. £72.4 million of such loans were borrowed at an average rate of 0.51 per cent and an average life of 160 days, which includes the replacement of maturing loans.

¹ Loans with maturities less than 1 year.

² Loans with maturities great than 1 year

7. The spread of interest rates on all external borrowing outstanding at 31 March 2016 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 0.01 per cent below the universe average.

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	81	431	0.62%
Long-term variable rate	0.0	0.0	na	195	3,029	1.92%
Short-term fixed	14.4	53.8	0.37%	112	796	0.87%
Long-term fixed	114.4	5,708.4	4.99%	6,868	319,940	4.84%
LOBO	5.0	213.5	4.27%	1,287	57,391	4.58%
Total	133.8	5,975.7	4.47%	8,542	381,588	4.48%

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 01/04/2015 £m	Investments Made £m	Maturities/ Investments Sold £m	Balance on 31/03/2016 £m	Ave. Rate % and Ave. Life (yrs)
UK Central Government					
- Short-term	-	35.2	(35.2)	-	
- Long-term	-	-	-	-	
UK Local Authorities					
- Short-term	3.1	30.0	(26.5)	6.6	0.63%
- Long-term	-	-	-	-	0.39 yrs
Banks and building societies and other organisations					
- Short-term	0.7	150.8	(132.8)	18.7	0.73%
- Long-term	-	-	-	-	0.26 yrs
Registered Providers of Social Housing	-	-	-	-	
AAA-rated Money Market Funds (MMF)	-	97.8	(97.8)	-	
Other Pooled Funds					
- Other MMF	-	-	-	-	
Bonds issued by Multilateral Development Banks	-	-	-	-	
Commercial Paper, Corporate Bonds and other marketable instruments	-	-	-	-	
Funds Managed Externally	-	-	-	-	
Loans to small businesses / other organisations	-	-	-	-	
TOTAL INVESTMENTS	3.8	313.8	(292.3)	25.3	0.70% 0.33 yrs
Increase/ (Decrease) in Investments £m				21.5	

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 2015-16 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 2016 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
31/03/2015	3.25	AA	2.61	AA
30/09/2015	5.01	A+	4.58	A+
31/12/2015	5.02	A+	3.96	AA-
31/03/2016	5.17	A+	4.65	A+
Strategy	Max 6.00	A-	Max 6.00	A-

Liquidity Management

14. In keeping with the CLG's Guidance on Investments, the council maintained a sufficient level of liquidity averaging £6.6 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 the council's average investment maturity profile was slightly above the group average at year end, although below the lower quartile throughout the year.

	Overall Weight Average Maturity				
	31-Mar-15	30-Jun-15	30-Sep-15	31-Dec-15	31-Mar-16
Upper Quartile	162.1 days	151.9 days	147.0 days	146.4 days	147.8 days
Group Average	131.9 days	137.1 days	129.2 days	136.1 days	135.4 days
Isle of Wight	95.9 days	60.8 days	97.8 days	57.8 days	144.4 days
Lower Quartile	63.4 days	59.6 days	71.2 days	64.6 days	58.2 days

Yield

16. 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 2015-16 was 0.46 per cent, the 6-month LIBID rate averaged 0.61 per cent and the 1-year LIBID rate averaged 0.90 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.
17. 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 £19.7 million during the period and interest earned was £113.2 thousand.
18. 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.
19. During 2015-16, the council had an average daily balance of £3.65 million lent to the pension fund, at an average interest rate of 0.41 per cent. The maximum amount outstanding at any point during the year was £6.5 million, on 31 March 2016.
20. At 31 March 2016, the council had invested (lent to) the pension fund £6.505 million, which is due to mature between 8 April 2016 and 27 February 2017. The largest individual amount lent was £2.45 million maturing 27 February 2017. It also had £16 million invested equally in Goldman Sachs, Barclays, Nationwide and Lloyds which are due to mature on 4 April 2016, 2 June 2016, 7 September 2016 and 1 March 2017 respectively. There was also £2.8 million invested in an instant access account with Santander UK.
21. 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 0.2 per cent below the universe average.

Annual Average Investment

	Authority			Group Total		
	Av. Balance £'m	Interest £'k	Rate	Av. Balance £'m	Interest £'k	Average Rate
Variable rate	6.6	40.7	0.62%	2,356	15,476	0.60%
Short-term fixed	13.0	78.0	0.60%	2,199	15,820	0.72%
Long-term fixed	0.0	0.0	na	604	7,914	1.66%
Externally Managed	0.0	0.0	na	193	3,022	2.40%
Total	19.6	118.7	0.60%	5,352	42,231	0.80%

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

Compliance

23. The council confirms that it has complied with its **Prudential Indicators** for 2015-16, which were approved on 19 February 2015 as part of the council's Treasury Management Strategy, which can be accessed through the following link:
<https://www.iwight.com/Meetings/committees/Audit%20Committee/19-2-15/Paper%20F.pdf>

A revised Treasury Management Strategy for 2015-16 was approved by audit committee on 29 September 2015, following the approval of a significant capital contract by council in July 2015. The revised strategy can be accessed through the following link:

<https://www.iwight.com/Meetings/committees/Audit%20Committee/29-9-15/PAPER%20G.pdf>

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

24. 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 2015-16. 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.
25. The council also confirms that during 2015-16 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:
26. During the period between 15 January and 18 January 2016, the council deposited £6,125,000 in an instant access account with National Westminster Bank (its main banker) for a period of 3 days. This was outside the parameters set within the treasury management strategy as follows:
- a. The Approved Investment Counterparties in the Investment strategy states that the council may invest, a maximum of £2.0 million in institutions with a minimum credit rating of BBB+, which was the rating that National Westminster Bank held at that time.
 - b. Investment Limits in the Investment Strategy specifies that in order that no more than 15% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £4.0 million
27. 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 decision being made, taking into account advice sought from Arlingclose.

Table 1: Debt and Investment Portfolio Position 31 March 2016

	31/3/2016 Actual Portfolio £m	31/3/2016 Average Rate %
External Borrowing:		
PWLB – Fixed Rate	107.9	5.17
Local Authorities	45.5	0.68
LOBO Loans	5.0	4.27
Total External Borrowing	158.4	3.85
Other Long Term Liabilities:		
PFI	68.4	
Finance Leases	0.6	
Total Gross External Debt	227.4	
Investments:		
<i>Managed in-house</i>		
Short-term investments	25.3	0.70
Total Investments	25.3	0.70
Net Debt	202.1	

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 6 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.

