AGENDA ITEM 5

Policy Committee – 18 July 2017

Treasury Management Outturn Report 2016/17

Report of the Strategic Manager – Financial Services (s151 officer)

Lead Member – Financial Resilience: Councillor Mulligan

Ward(s) affected: All

1. Purpose of Report

To inform Members of the treasury activity undertaken in the year in the context of current and forecast economic climates.

2. Recommendations

Members are recommended to:

- Note the actual Treasury Management Indicators for 2016/17;
- Note the Treasury Management Annual Report for 2016/17

3. Introduction

3.1 The Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2016/17. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

3.2 During 2016/17 the reporting requirements were that the full Council or delegated committee should receive the following reports:

- an annual treasury strategy in advance of the year (Council 25/02/2016);
- an amendment to the treasury strategy resulting from a review of permitted Unspecified Investments (Council 24/04/2016 POL750);
- a mid-year treasury update report (Policy Committee 13/12/2016);
- an annual review following the end of the year describing the activity compared to the strategy (this report).

3.3 The regulatory environment places responsibility on Members for the review and scrutiny of treasury management policy and activities. This report is, therefore, important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by Members.

3.4 This Council confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Policy Committee before they were reported to the full Council.

4. The Council's Capital Expenditure and Financing

The Council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or
- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

Table 1

	2015/16 Actual £000	2016/17 Estimate £000	2016/17 Actual £000
Capital expenditure	1,330	1,531	1,372
Financed in year	1,055	1,049	1,122
Unfinanced capital expenditure	275	482	250

5. Borrowing and the Capital Financing Requirement

5.1 The Council's Overall Borrowing Need

The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's indebtedness. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represents the 2016/17 unfinanced capital expenditure (see above table), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

Part of the Council's treasury activity is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, finance officers organise the Council's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the Government, through the Public Works Loan Board [PWLB] or the money markets), or utilising temporary cash resources within the Council.

5.2 Reducing the CFR – the Council's underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision (MRP), to reduce the CFR. This is effectively a repayment of the borrowing need. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

The total CFR can also be reduced by:

- the application of additional capital financing resources (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

5.3 The Council's 2016/17 MRP Policy (as required by CLG Guidance) was approved as part of the Treasury Management Strategy Report for 2016/17 on 25/02/2016.

5.4 The Council's CFR for the year is shown below, and represents a key prudential indicator.

Table 2

CFR	31 March 2016 Actual £000	31 March 2017 Budget £000	31 March 2017 Actual £000
Opening balance	5,533	5,676	5,533
Add unfinanced capital expenditure (as above)	275	482	250
Less MRP	(275)	(320)	(319)
Closing balance	5,533	5,838	5,464

Borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit.

5.5 Gross borrowing and the CFR - In order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allowed the Council some flexibility for borrowing in advance of its immediate capital needs in 2016/17. The table below highlights the Council's gross borrowing position against the CFR.

The Council has complied with this prudential indicator.

Table 3

	31 March 2017 Actual £000	31 March 2018 Forecast £000	31 March 2019 Forecast £000
Gross borrowing position	5,988	5,988	5,988
CFR	5,464	5,981	6,734

(The gross borrowing position for 2016/17 is slightly above CFR but only in the short term.)

5.6 The authorised limit - the authorised limit is the “affordable borrowing limit” required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level unless Council approves a change as a result of a change in circumstances. The table below demonstrates that during 2016/17 the Council has maintained gross borrowing within its authorised limit.

5.7 The operational boundary – the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary is acceptable subject to the authorised limit not being breached.

5.8 Actual financing costs as a proportion of net revenue stream - this indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

Table 4

	2016/17 £000
Authorised limit	12,750
Maximum gross borrowing position	5,988
Operational boundary	10,500
Average gross borrowing position	5,988
Financing costs as a proportion of net revenue stream 2016/17 *	4.82%
Financing costs as a proportion of net revenue stream 2015/16	5.63%

(Net revenue stream is the total of taxation and non-specific grant income)

6. Treasury Position as at 31 March 2017

6.1 The Council’s debt and investment position is organised by finance officers in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through member reporting as detailed in the summary, and through officer activity detailed in the Council’s Treasury Management Practices. At the end of 2016/17 the Council‘s treasury position was as follows:

Table 5

	31 March 2016 Principal £000	Average Rate	Average Life	31 March 2017 Principal £000	Average Rate	Average Life
Total debt	5,988	4.27%	21.9yrs	5,988	4.27%	20.95yrs
CFR	5,532			5,464		
Over/(under) borrowing	0.456			0.524		
Investments	11,707	0.59%	183days	14,020	0.52%	207days

6.2 The maturity structure of the debt portfolio was as follows:

Table 6

	31 March 2016 actual	2016/17 original limits	31 March 2017 actual
Under 12 months	0	600	0
12 months and within 24 months	0	900	0
24 months and within 5 years	0	900	500
5 years and within 10 years	1,000	1,200	500
10 years and within 25 years	700	2,400	700
25 years and over	4,288	5,390	4,288

All investments were for less than one year.

7. The Strategy for 2016/17

7.1 The expectation for interest rates within the strategy for 2016/17 anticipated low but rising Bank Rate (starting in quarter 4 of 2016), and gradual rises in medium and longer term fixed borrowing rates during 2016/17. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period. Continued uncertainty in the aftermath of the 2008 financial crisis promoted a cautious approach, whereby investments would continue to be dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

7.2 In this scenario, the treasury strategy was to postpone borrowing to avoid the cost of holding higher levels of investments at low interest rates, and to reduce counterparty risk.

7.3 During 2016/17 there was major volatility in PWLB rates with rates falling during quarters 1 and 2 to reach historically low levels in July and August, before rising significantly during quarter 3, and then partially easing back towards the end of the year.

8. The Economy & Interest Rates

The two major landmark events that had a significant influence on financial markets in the 2016-17 financial year were the UK EU referendum on 23 June and the election of President Trump in the USA on 9 November. The first event had an immediate impact in terms of market expectations of when the first increase in Bank Rate would happen, pushing it back from quarter 3 2018 to quarter 4 2019. At its meeting on 4 August, the Monetary Policy Committee (MPC) cut Bank Rate from 0.5% to 0.25% and the Bank of England's Inflation Report produced forecasts warning of a major shock to economic activity in the UK, which would cause economic growth to fall almost to zero in the second half of 2016. The MPC also warned that it would be considering cutting Bank Rate again towards the end of 2016 in order to support growth. In addition, it restarted quantitative easing with purchases of £60bn of gilts and £10bn of corporate bonds, and also introduced the Term Funding Scheme whereby potentially £100bn of cheap financing was made available to banks.

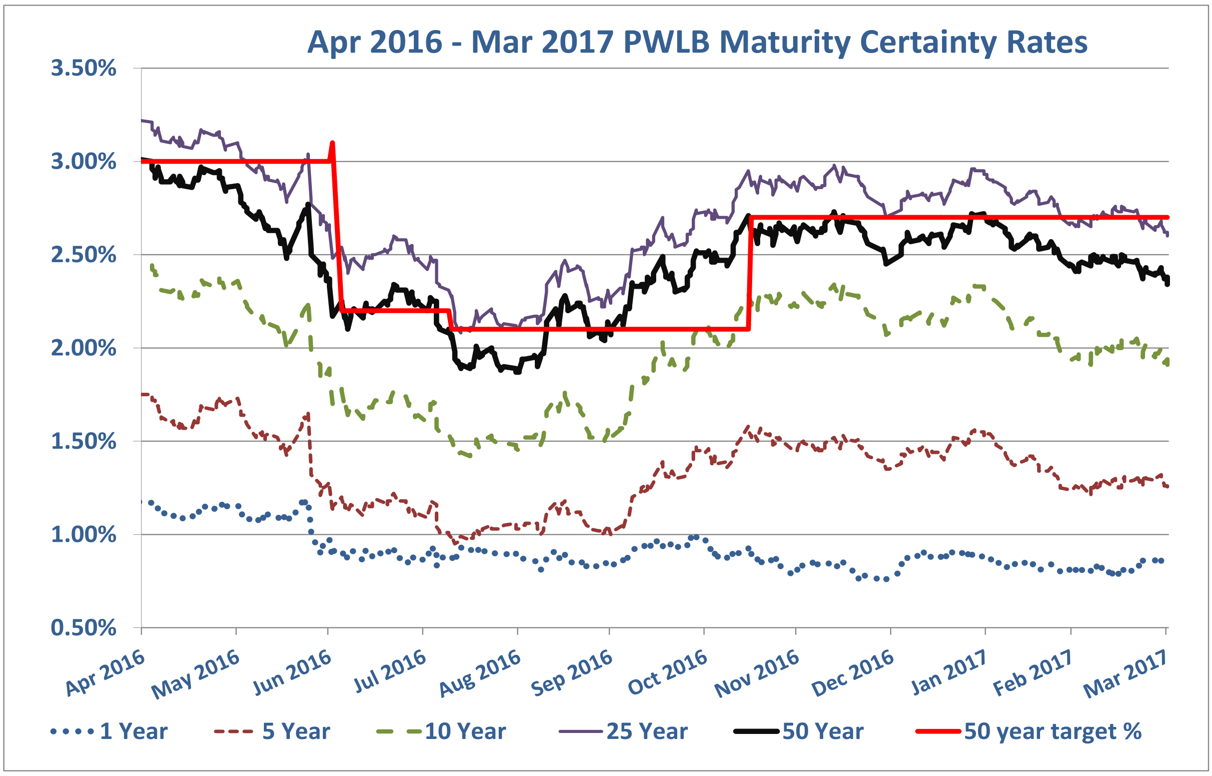
In the second half of 2016, the UK economy confounded the Bank's pessimistic forecasts of August. After a disappointing quarter 1 of only +0.2% GDP growth, the three subsequent quarters of 2016 came in at +0.6%, +0.5% and +0.7% to produce an annual growth for 2016 overall, compared to 2015, of no less than 1.8%, which was very nearly the fastest rate of growth of any of the G7 countries. Needless to say, this meant that the MPC did not cut Bank Rate again after August but, since then, inflation has risen rapidly due to the effects of the sharp devaluation of sterling after the referendum.

Financial markets following the US Presidential election have been bouyed by the upward climb of the US economy after an initial, but brief, downturn.

9. Borrowing Position

9.1 Borrowing Rates in 2016/17.

The graph below shows how PWLB certainty rates have fallen to historically low levels during the year:



9.2 Borrowing Outturn for 2016/17.

Due to investment concerns, both counterparty risk and low investment returns, no borrowing was undertaken during the year.

The following table shows the Councils current borrowing:

Table 7

Lender	Date of Borrowing	Date of Maturity	Value	Interest Rate	Interest Paid
PWLB	04/11/2013	04/05/2021	500,000	2.89%	14,450
PWLB	04/11/2013	04/05/2023	500,000	3.28%	16,400
PWLB	01/12/2005	01/02/2031	700,000	4.25%	29,750
PWLB	17/09/2007	01/08/2057	2,000,000	4.55%	91,000
PWLB	17/09/2007	01/08/2057	2,288,110	4.55%	104,109

10. Investment Position

10.2 Investment Rates in 2016/17.

After the EU referendum, Bank Rate was cut from 0.5% to 0.25% on 4 August and remained at that level for the rest of the year. Market expectations as to the timing of the start of monetary tightening started the year at quarter 3 2018, but then moved back to around the end of 2019 in early August before finishing the year back at quarter 3 2018.

Deposit rates continued into the start of 2016/17 at previous depressed levels but then fell during the first two quarters and fell even further after 4 August MPC meeting resulted in a large tranche of cheap financing being made available to the banking sector by the Bank of England.
Rates made a weak recovery towards the end of 2016 but then fell to fresh lows in March 2017.

11. Investment Outturn for 2016/17

11.1 Investment Policy – the Council's investment policy is governed by CLG guidance, which has been implemented in the annual investment strategy approved by the Council on 25th February 2016 and updated in April 2016. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data (such as rating outlooks, credit default swaps, asset holdings, etc.) when a more-detailed analysis is required.

The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

11.2 Resources – the Council's cash balances comprise revenue and capital resources and cash flow monies. The Council's core cash resources comprised as follows:

Table 8

Balance Sheet Resources (£000)	31 March 2016 £000	31 March 2017 £000
Balances	995	995
Earmarked reserves	5,786	6,596
Usable capital receipts	2,950	3,059
Total	**9,731**	**10,650**

11.3 The Council had an average balance of £15.697m of internally managed funds. The internally managed funds earned an average rate of return of 0.70%. This compares with a budget assumption of £9m investment balances earning an average rate of 0.76%.

Additionally, the Council's investment income was boosted by a discount of £14,730 on the annual pensions contribution as a result of making a payment in advance. The total of investment income received from all sources is therefore £127,496.

A list of investments and their interest rates still held at the end of the financial year is attached at Appendix A.

12. Prudential and treasury indicators

The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

Table 9

Prudential Indicators	2015/16 Actual £000	2016/17 Original £000	2016/17 Actual £000
Capital expenditure	1,330	1,328	1,372
Capital Financing Requirement	5,533	5,950	5,464
Gross borrowing in year	0	0	0
Total external debt	5,988	5,988	5,988
Total investments	11,707	8,956	14,000
Net investments	5,719	2,962	8,012

Table 10

Treasury Management Indicators	2015/16 Actual £000	2016/17 Original £000	2016/17 Actual £000
Authorised Limit for external debt	9,750	12,750	12,750
Operational Boundary for external debt	7,500	10,500	10,500
Actual external debt	5,988	5,988	5,988
Upper limit for fixed interest rate exposure expressed as net principal re fixed rate borrowing/investments	7,500	10,500	10,500
Upper limit for variable rate exposure expressed as net principal re variable rate borrowing/investments	0	0	0
Upper limit for total principal sums invested for over 364 days	0	0	0

13. Implications

14.1 Financial Implications - There are no financial implications associated with this report.

14.2 Legal Implications - There are no legal implications attached to this report.

14. Contribution to Corporate Priorities

The Treasury Management function does not contribute directly to the Council’s Corporate Priorities albeit the delivery of the Treasury Management Strategy supports the Council’s budget strategy which in turn is a fundamental element of the Council’s service and financial planning approach to achievement of the Council Plan.

15. Risk Management

There are no direct risk management implications arising from this report. Regular review provides assurance that treasury management activities are being managed in line with the Treasury Management Strategy.

16. Equalities Impact Assessment

Since this report is not seeking to set or amend policy, the Council's Equality Impact Assessment procedure has not been followed.

17. Consultations with Others

None

18. Access to Information : Background Documents

Working papers held in Financial Services.

19. Author of the Report

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Note: Members are invited to contact the author in advance of the meeting with any detailed queries or questions.

Appendix A

Counterparty	**Date of Investment**	**Date of Maturity**	**Value**	**Interest Rate**
Fixed term:				
Cumberland BS	03/01/2017	13/04/2017	1,000,000	0.34%
Nottingham BS	01/07/2016	30/06/2017	500,000	0.75%
National Counties BS	07/09/2016	06/09/2017	1,000,000	0.78%
West Bromwich BS	30/09/2016	29/09/2017	1,000,000	0.75%
Newcastle BS	03/10/2016	02/10/2017	500,000	0.75%
Progressive BS	03/10/2016	02/10/2017	1,000,000	0.75%
Lloyds Bank	01/12/2016	01/12/2017	1,500,000	1.00%
Leeds BS	03/01/2017	01/01/2018	1,000,000	0.58%
Bank of Scotland	16/01/2017	16/01/2018	1,000,000	0.90%
Lloyds Bank	16/01/2017	16/01/2015	500,000	0.90%
Newcastle BS	13/02/2017	12/02/2018	500,000	0.75%
Nottingham BS	13/02/2017	12/02/2018	500,000	0.76%
Notice Accounts:				
Santander 95-day	07/10/2015	On notice	1,500,000	0.65%
Money Market Funds:				
Legal & General Stlg Liquidity	n/a	n/a	500,000	0.24%
Standard Life Stlg Liquidity	n/a	n/a	2,000,000	0.29%
TOTAL INVESTMENTS			**14,000,000**	

Transaction Accounts:				
Lloyds Bank Current Account	n/a	n/a	1,091,830	0.40%
Bank of Scotland	n/a	n/a	20,020	0.15%