Agenda Item No:	10	
Committee:	Council	
Date:	13 July 2017	
Report Title:	Treasury Management Annual Report 2016/17	

Cover sheet:

1 Purpose / Summary

The purpose of this report is to consider the overall financial and operational performance of the Council's treasury management activity for 2016/17.

2 Key issues

- In accordance with the Treasury Management Strategy approved in February 2017, Council receives an annual report after the financial year-end on its' treasury management activities.
- The Treasury Management Annual Report 2016/17 as considered by Cabinet on 15 June 2017 and Corporate Governance Committee on 13 July 2017 is attached.
- The report highlights all the key activities carried out within the Treasury Management function during 2016/17. All activities have been conducted in accordance with the approved strategy and policies.
- 2016/17 has been a challenging year and the report highlights the success in maximising investment income whilst ensuring the security and liquidity of the Council's investments.

3 Recommendations

- It is recommended that members note the report.

Wards Affected	All
Portfolio Holder(s)	Cllr John Clark, Leader Cllr Chris Seaton, Portfolio Holder for Finance
Report Originator(s)	Brendan Arnold, Corporate Director and Chief Finance Officer Mark Saunders, Chief Accountant
Contact Officer(s)	Brendan Arnold, Corporate Director and Chief Finance Officer Mark Saunders, Chief Accountant
Background Paper(s)	Treasury Management and Annual Investment Strategy 2016/17

Agenda Item No:		
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4 Purpose / Summary

The purpose of this report is to consider the overall financial and operational performance of the Council's treasury management activity for 2016/17. This report has been considered by Cabinet on 15 June 2017 and will be presented to Council on 21 July 2017.

5 Key issues

- Outstanding loans and finance lease liabilities of £8,729,796 and temporary investments of £21,300,000 as at 31 March 2017.
- The average rate on the long term external debt portfolio was 5.71% at 31 March 2017.
- Due to the Council's long term PWLB debt portfolio (£4.5m at 31/03/17) currently attracting excessive premiums it was not financially advantageous for the Council to comply with the Gross borrowing and Capital Financing Prudential Indicator in 2016/17. This is consistent with the strategy approved by Council in February 2016.
- One finance lease commenced, no new borrowing was undertaken and the authorised limit was not breached during 2016/17.
- The investment activity during the year conformed to the approved strategy and the Council had no liquidity difficulties.
- Amount received from external investments £155,627.
- Overall interest rate achieved from investments 0.56% (7 day LIBID uncompounded rate for 2016/17 0.20%).

6 Recommendations

- It is recommended that members note the report.

Wards Affected	All
Portfolio Holder(s)	Cllr John Clark, Leader Cllr Chris Seaton, Portfolio Holder, Finance
Report Originator(s)	Brendan Arnold, Corporate Director and Chief Finance Officer Mark Saunders, Chief Accountant
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Report:

1 Introduction

1.1 The Council is required through 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 Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

1.2 During 2016/17 the minimum reporting requirements were that Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 25/02/2016);
- a mid-year treasury update report (Council 15/12/2016);
- an annual review following the end of the year, describing the activity compared to the strategy (this report).

1.3 The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members.

1.4 The 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 Corporate Governance Committee before they were reported to Council.

2 The Economy and Interest Rates

2.1 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.

2.2 At its 4 August meeting, the Monetary Policy Committee (MPC) cut back bank rate from 0.50% 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.

2.3 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.

3 Overall Treasury Position as at 31 March 2017

3.1 At the beginning and end of 2016/17 the Council's treasury position was as follows.

	31 March 2017 Principal £000	Rate / Return	Average Life years	**31 March 2016 Principal £000**	Rate / Return	Average Life years
Fixed rate funding						
• PWLB	**4,500**	7.29%	13.40 yrs	**4,500**	7.29%	14.40 yrs
• LOBO	**3,300**	4.70%	36.96 yrs	**3,300**	4.70%	37.96 yrs
• Finance Leases	**930**	2.23%	4.24 yrs	**1,013**	1.64%	4.25 yrs
Total debt	**8,730**			**8,813**		
Investments	**(21,300)**	0.56%		**(18,550)**	0.67%	
Net debt /(Investments)	**(12,570)**			**(9,737)**		

4 The Strategy for 2016/17

4.1 The expectation for interest rates within the treasury management strategy for 2016/17 anticipated low but rising bank rate, starting in quarter 1 of 2017 and gradual rises in the 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.

4.2 The Treasury Strategy was to postpone borrowing to avoid the cost of holding higher levels of investments and to reduce counterparty risk.

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

5 The Borrowing Requirement

5.1 The Council's Capital Financing Requirement (CFR) for the year is shown below and represents a key prudential indicator.

	31 March 2016 Actual £000	31 March 2017 Estimate £000	31 March 2017 Actual £000
CFR opening balance	663	1,063	1,063
Capital expenditure	587	767	160
Less finance lease repayments	(187)	(242)	(242)
CFR Closing balance	1,063	1,588	981

5.2 The reduction in the CFR at 31 March 2017 compared to the estimate reflects the underspend on the capital programme, in particular the delay in receiving two new refuse vehicles and the associated finance lease arrangements and there being no requirement to utilise internal borrowing arrangements in the year.

5.3 The CFR includes finance leases. A finance lease is a commercial arrangement between the Council and a lessor (finance company), where in consideration for a series of payments the Council has the right to use an asset (e.g. refuse vehicle, leisure equipment) for the lease duration (typically 3 to 7 years). The annual lease payment is made up of a capital and interest repayment.

5.4 Although legally the Council doesn't own the asset during the lease duration, International Accounting Standards require that the Council capitalise the asset and liability on its balance sheet, much like a loan.

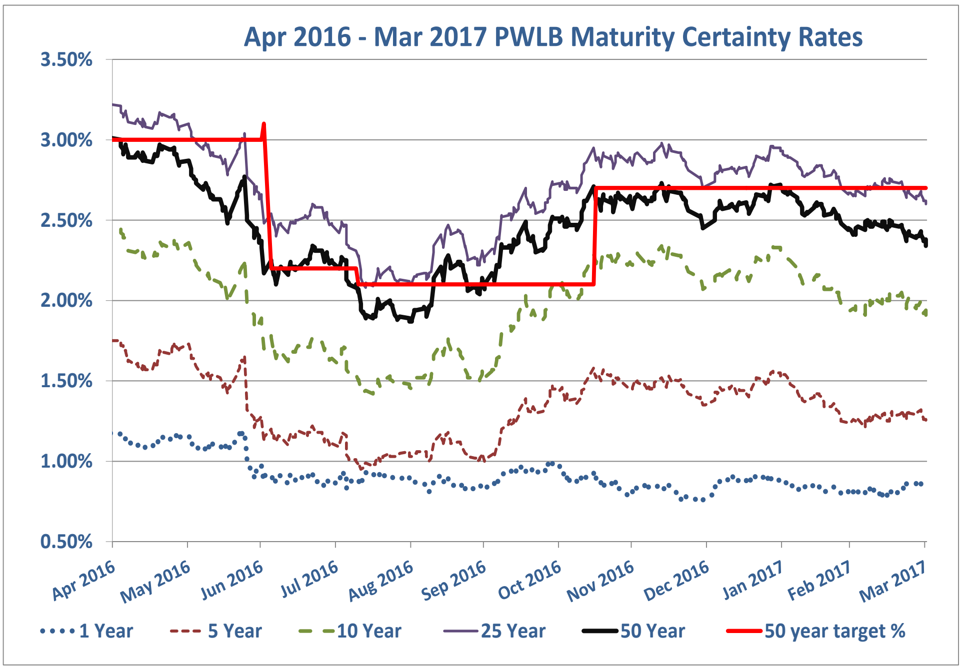
5.5 One of the key prudential indicators is gross borrowing and the CFR. This indicator is to ensure that borrowing levels are prudent over the medium term and only for a capital purpose. The Council should ensure that its gross debt, does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2016/17 and the following two financial years. This allows some flexibility for limited early borrowing for future years and ensures that long term borrowing is not undertaken for revenue purposes. Appendix A highlights the Council's borrowing position against the CFR.

5.6 As a result of the Council's long term PWLB debt portfolio (£4.5m at 31/03/17) currently attracting excessive premiums (£3.381m at the time of writing this report), if it were prematurely repaid, it is not financially advantageous for the Council to comply with this prudential indicator. This is consistent with the strategy approved by Council in February 2016.

5.7 The authorised limit is the "affordable borrowing limit" required by S3 of the Local Government Act 2003. The Council does not have the power to borrow above this level. 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. The authorised limit was not breached during 2016/17.

6 Borrowing Outturn

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

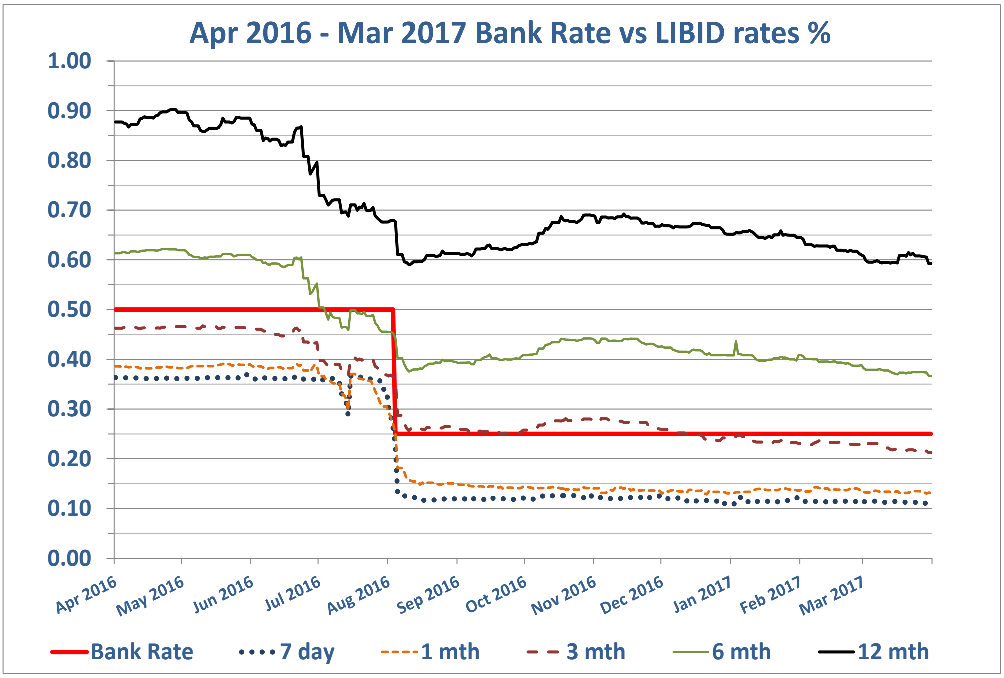


6.2 During 2016/17 the Council entered into a finance lease for the use of a refuse vehicle (see paragraph 5 above). This commercial arrangement increased the net debt of the Council by £159k at 31 March 2017. No other long term or temporary borrowing was required. The approach during the year was to use cash balances to finance new capital expenditure, so as to run down cash balances that were earning low investment returns and to minimise counterparty risk incurred on investments.

6.3 No rescheduling was completed during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates and the penalty position which can arise from early repayment of debt, made rescheduling unviable.

7 Investment Outturn

7.1 After the EU referendum, bank rate was cut from 0.50% 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, 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 the 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.



7.2 The Council's investment policy is governed by Communities and Local Government guidance, which has been implemented in the annual investment strategy approved by Council on 25 February 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 and bank share price).

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

7.4 The Council maintained an average balance of £24.577m of internally managed funds. The internally managed funds earned an average rate of return of 0.56% (£155,627). The comparable performance indicator is the average 7-day LIBID rate, which was 0.20%.

8 Prudential and Treasury Indicators

8.1 During 2016/17 the Council complied with its legislative and regulatory requirements with the exception of gross borrowing and the CFR (see paragraph 5.5 above).

Appendix A - Prudential Indicators

	Prudential Indicators	2015/16 Actual £000	2016/17 Estimate £000	**2016/17 Actual £000**
1	**Capital Expenditure**	2,965	3,427	**2,550**
2	**Ratio of Financing Costs to Net Revenue Stream (external interest – investment income)**	2.35%	3.03%	**2.93%**
3	**Gross Borrowing and the Capital Financing Requirement**			
	Gross Debt	8,813	8,901	**8,730**
	CFR	1,063	1,588	**981**

	Treasury Management Indicators	2015/16 Actual £000	2016/17 Estimate £000	**2016/17 Actual £000**
4	**Authorised Limit for External Debt**			
	Borrowing	15,000	15,000	**15,000**
	Other Long Term Liabilities	2,000	2,000	**2,000**
	Total	17,000	17,000	**17,000**
5	**Operational Boundary for External debt**			
	Borrowing	10,000	10,000	**10,000**
	Other Long Term Liabilities	2,000	2,000	**2,000**
	Total	12,000	12,000	**12,000**
6	**Actual External debt (as at 31 March)**			
	Borrowing	7,800	7,800	**7,800**
	Other Long Term Liabilities	1,013	1,101	**930**
	Total	8,813	8,901	**8,730**
7	**Interest Rate Exposures**			
	Upper Limit - Fixed Rates	(4,987)	(8,339)	**(8,070)**
	Upper Limit - Variable Rates	(4,750)	(10,200)	**(4,500)**
8	**Upper Limit for Total Principal Sums Invested for Periods Longer than 364 Days**	0	10,000	**0**