Report for: Corporate Committee 25 July 2017

Title: Treasury Management Outturn 2016/17

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Ward(s) affected: N/A

Report for Key/ Non Key Decision: Non Key decision

1. Describe the issue under consideration

1.1. The Chartered Institute of Public Finance and Accountancy's Treasury Management Code (CIPFA's TM Code) requires that Authorities report on the performance of the treasury management function at least twice yearly (mid-year and at year end).

1.2. The Council's Treasury Management Strategy for 2016/17 was approved by Full Council on 22 February 2016.

1.3. This report updates the Committee on the Council's treasury management activities and performance in the year to 31st March 2017 in accordance with the CIPFA Treasury Management Code of Practice.

2. Cabinet Member Introduction

2.1. Not applicable.

3. Recommendations

3.1. That members note the Treasury Management activity undertaken during the year to 31st March 2017 and the performance achieved.

3.2. That members note that all treasury activities were undertaken in line with the approved Treasury Management Strategy: in particular the prudential indicators with fixed limits shown in appendix 1.

4. Reason for Decision

4.1. None.

5. Other options considered

5.1. None.

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6. Background information

6.1. The Council's treasury management activity is underpinned by CIPFA's Code of Practice on Treasury Management ("the Code"), which requires local authorities to produce annually, Prudential Indicators and a Treasury Management Strategy Statement. CIPFA has defined Treasury management as: "The management of the local Council's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

6.2. The Code recommends that members are informed of treasury management activities at least twice a year. Formulation of treasury policy, strategy and activity is delegated to the Corporate Committee and this Committee receives reports quarterly.

6.3. However, overall responsibility for treasury management remains with Full Council and the Council approved the Treasury Management Strategy Statement and set the Prudential Indicators for 2016/17 on 22 February 2016. The Corporate Committee is responsible for monitoring treasury management activity and this is achieved through the receipt of quarterly reports.

6.4. Government guidance on local Council treasury management states that local authorities should consider the following factors in the order they are stated:
Security - Liquidity - Yield

6.5. The Treasury Management Strategy reflects these factors and is explicit that the priority for the Council is the security of its funds. However, no treasury activity is without risk and the effective identification and management of risk are integral to the Council's treasury management activities.

7. Contribution to Strategic Outcomes

7.1. None.

8. Statutory Officers comments (Chief Finance Officer (including procurement), Assistant Director of Corporate Governance, Equalities)

<u>Finance and Procurement</u>

8.1. Interest rates earned on investments remain low and significantly less than the cost of new borrowing and therefore the strategy of minimising cash balances continued in 2016-17. Borrowing will be taken only when required for liquidity purposes with the preference being short term local authorities' loans at very low rates. However longer term interest rates continue to be carefully monitored. The ability to take advantage of low interest rates in this way has resulted in savings on the treasury management budget.

Legal

8.2. The Assistant Director for Corporate Governance has been consulted on the content of this report which is consistent with legislation governing the financial affairs of the Council. In considering the report Members must take into account the expert financial advice available to it and any further oral advice given at the meeting of the Committee.

Equalities

8.3. There are no equalities issues arising from this report.

9. Use of Appendices

9.1. Appendix 1 – Prudential Indicators

10. Local Government (Access to Information) Act 1985

10.1. Not applicable.

11. External Context and Economic Commentary and Outlook

Economic background:

11.1. Politically, 2016/17 was an extraordinary twelve month period which defied expectations when the UK voted to leave the European Union and Donald Trump was elected the 45th President of the USA. Uncertainty over the outcome of the US presidential election, the UK's future relationship with the EU and the slowdown witnessed in the Chinese economy in early 2016 all resulted in significant market volatility during the year. Article 50 of the Lisbon Treaty, which sets in motion the 2-year exit period from the EU, was triggered on 29th March 2017.

11.2. UK inflation had been subdued in the first half of 2016 as a consequence of weak global price pressures, past movements in sterling and restrained domestic price growth. However the sharp fall in the Sterling exchange rate following the referendum had an impact on import prices which, together with rising energy prices, resulted in CPI rising from 0.3% year/year in April 2016 to 2.3% year/year in March 2017.

11.3. In addition to the political fallout, the referendum's outcome also prompted a decline in household, business and investor sentiment. The repercussions on economic growth were judged by the Bank of England to be sufficiently severe to prompt its Monetary Policy Committee (MPC) to cut the Bank Rate to 0.25% in August and embark on further gilt and corporate bond purchases as well as provide cheap funding for banks via the Term Funding Scheme to maintain the supply of credit to the economy.

11.4. Despite growth forecasts being downgraded, economic activity was fairly buoyant and GDP grew 0.6%, 0.5% and 0.7% in the second, third and fourth calendar quarters of 2016. The labour market also proved resilient, with the ILO unemployment rate dropping to 4.7% in February, its lowest level in 11 years.

11.5. Following a strengthening labour market, in moves that were largely anticipated, the US Federal Reserve increased rates at its meetings in December 2016 and March 2017, taking the target range for official interest rates to between 0.75% and 1.00%.

Financial Markets:

11.6. Following the referendum result, gilt yields fell sharply across the maturity spectrum on the view that Bank Rate would remain extremely low for the foreseeable future. After September there was a reversal in longer-dated gilt yields which moved higher, largely due to the MPC revising its earlier forecast that Bank Rate would be dropping to near 0% by the end of 2016. The yield on the 10-year gilt rose from 0.75% at the end of September to 1.24% at the end of December, almost back at pre-referendum levels of 1.37% on 23rd June. 20- and 50-year gilt yields also rose in Q3 2017 to 1.76% and 1.70% respectively, however in Q4 yields remained flat at around 1.62% and 1.58% respectively.

11.7. After recovering from an initial sharp drop in Q2, equity markets rallied, although displaying some volatility at the beginning of November following the US presidential election result. The FTSE-100 and FTSE All Share indices closed at 7342 and 3996 respectively on 31st March, both up 18% over the year. Commercial property values fell around 5% after the referendum, but had mostly recovered by the end of March.

11.8. Money market rates for overnight and one week periods remained low since Bank Rate was cut in August. 1- and 3-month LIBID rates averaged 0.36% and 0.47% respectively during 2016-17. Rates for 6- and 12-months increased between August and November, only to gradually fall back to August levels in March, they averaged 0.6% and 0.79% respectively during 2016-17.

Credit background:

11.9. Various indicators of credit risk reacted negatively to the result of the referendum on the UK's membership of the European Union. UK bank credit default swaps saw a modest rise but bank share prices fell sharply, on average by 20%, with UK-focused banks experiencing the largest falls. Non-UK bank share prices were not immune, although the fall in their share prices was less pronounced.

11.10. Fitch and Standard & Poor's downgraded the UK's sovereign rating to AA. Fitch, S&P and Moody's have a negative outlook on the UK. Moody's has a negative outlook on those banks and building societies that it perceives to be exposed to a more challenging operating environment arising from the 'leave' outcome.

11.11. None of the banks on the Authority's lending list failed the stress tests conducted by the European Banking Authority in July and by the Bank of England in November, the latter being designed with more challenging stress scenarios, although Royal Bank of Scotland was one of the weaker banks in both tests. The tests were based on banks' financials as at 31st December 2015, 11 months out of date for most. As part of its creditworthiness research and advice, the Authority's treasury advisor Arlingclose regularly undertakes analysis of relevant ratios - "total loss absorbing capacity" (TLAC) or "minimum requirement for eligible liabilities" (MREL) - to determine whether there would be a bail-in of senior investors, such as local authority unsecured investments, in a stressed scenario.

12. Local Context

12.1. At 31/3/2017 the Council's underlying need to borrow for capital purposes as measured by the Capital Financing Requirement (CFR) was £575.2m. The Council had actual borrowing of £347.0m and £18.6m of investments.

12.2. The Council's current strategy is to maintain borrowing below the Capital Financing Requirement (CFR), this is referred to as internal borrowing.

12.3. The Council has an increasing CFR over the next 3 years due to the capital programme, but minimal investments which can be used to fund capital plan cashflows. The Council is likely to need to borrow over the forecast 3 year period.

13. Borrowing Strategy During the Year

13.1. At 31/03/2017 the Council held £270.6m of long term loans, (a decrease of £12.6m on 31/3/2016).

13.2. The Council's chief objective when borrowing continues to be striking an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Council's long-term plans change being a secondary objective.

13.3. Affordability and the "cost of carry" remained important influences on the Council's borrowing strategy alongside the consideration that, for any borrowing undertaken ahead of need, the proceeds would have to be invested in the money markets at rates of interest significantly lower than the cost of borrowing. Based on professional advice received from the Council's Treasury Management advisor Arlingclose, short-term interest rates are likely to remain low for a significant period, lower than long-term rates, and the Council determined it was more cost effective in the short-term to use internal resources or borrow with short-term loans instead.

13.4. The benefits of internal borrowing were monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise. Arlingclose, the Council's treasury management advisor assists the Council with this 'cost of carry' and breakeven analysis.

Borrowing Activity

Borrowing	Balance at 1 Apr 2016 £'000	Borrowing Raised £'000	Maturities £'000	Balance at 31 Mar 17 £'000	Avg Rate %
Short term Borrowing - UK Local Authorities	29,000	380,000	332,600	76,400	0.30

Long Term Borrowing					
- PWLB	158,233	0	12,587	145,646	5.56
- LOBO	125,000	0	0	125,000	4.72
TOTAL BORROWING	312,233	380,000	345,187	347,046	4.10

13.5. **LOBOs:** The Council holds £125m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. £50m of these LOBOS had options during the 2016/17 financial year, none of which were exercised by the lenders. The Council acknowledges there is an element of refinancing risk even though in the current interest rate environment lenders are unlikely to exercise their options.

14. Investment Activities

14.1. The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. Average investment balances were £23m in 2016/17.

14.2. The Guidance on Local Government Investments in England gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles

14.3. The Council has sought to minimise its security risk by setting limits on each institution on the lending list. The Council has complied with all these limits during the financial year to date.

14.4. The economic environment remains uncertain, and given this background, the Council has kept cash investments to a minimum and short term. Money Market Funds continue to be used extensively as the portfolios are spread across a range of underlying investments to diversify risk. They also provide instant access enabling officers to take action quickly if there are any concerns about creditworthiness. The remainder of the Council's investments are held with the DMO (government agency).

Investment Activity

Investments	Balance at 1 Apr 2016 £'000	Investments Made £'000	Maturities £'000	Balance at 31 Mar 17 £'000	Avg Rate /Yield %
Short term Investments (call accounts, deposits)					
- Banks & Building Societies	0	0	0	0	0
UK Government:					
- Deposits at Debt Management Office	0	335,935	325,935	10,000	0.18
- UK Local Authorities	10,000	0	10,000	0	0.50
Money Market Funds	7,600	303,610	302,635	8,575	0.36
TOTAL INVESTMENTS	17,600	639,545	638,570	18,575	0.33

Credit Risk

14.5. The table below shows counterparty credit quality as measured by credit ratings and the percentage of the in-house investment portfolio exposed to bail-in risk.

Date	Value Weighted Average - Credit Risk Score	Value Weighted Average - Credit Rating	Time Weighted Average - Credit Risk Score	Time Weighted Average - Credit Rating	Investments exposed to bail-in risk %
31/03/2016	2.61	AA-	2.33	AA-	21
30/06/2016	3.71	AA-	3.71	AA-	100
30/09/2016	3.98	AA-	3.98	AA-	100
31/12/2016	4.49	AA-	4.49	AA-	100
31/03/2017	3.49	AA	3.06	AA	46

Scoring:
-Value weighted average reflects the credit quality of investments according to the size of the deposit
-Time weighted average reflects the credit quality of investments according to the maturity of the deposit
-AAA = highest credit quality = 1
- D = lowest credit quality = 26
-Aim = A- or higher credit rating, with a score of 7 or lower, to reflect current investment approach with main focus on security

Budgeted Income and Outturn

14.6. The UK Bank Rate had been maintained at 0.5% since March 2009 until August 2016, when it was cut to 0.25%. Short-term money market rates have remained at relatively low levels. Following the reduction in Bank Rate, rates for very short-dated periods (overnight – 1 month) fell to between 0.1% and 0.2%. Debt Management Account Deposit Facility (DMADF) rates fell to 0.10% in March 2017.

14.7. Investments in Money Market Funds generated an average rate of 0.36%. The Council's investment income for the year £134.0k against a budget of £136.5k.

15. Compliance with Prudential Indicators

15.1. The Council confirms compliance with its Prudential Indicators for 2016/17, which was set in February 2016 as part of the Council's Treasury Management Strategy Statement.

Treasury Management Indicator

15.2. The Council measures and manages its exposures to treasury management risks using the following indicators.

15.3. **Interest Rate Exposures**: This indicator is set to control the Council's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of net principal borrowed were:

	2016/17	2017/18	2018/19
Upper limit on fixed interest rate exposure	100%	100%	100%
Actual	99%		
Upper limit on variable interest rate exposure	40%	40%	40%
Actual	6%		

15.4. Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate.

15.5. **Maturity Structure of Borrowing:** This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing are:

Maturity structure of borrowing (U: upper, L: lower)	**L**	**U**	**Outturn as at 31 Mar 2017**
under 12 months	0%	40%	4.5%
12 months & within 2 years	0%	35%	3.9%
2 years & within 5 years	0%	35%	10.4%
5 years & within 10 years	0%	35%	8.0%
10 yrs & within 20 yrs	0%	35%	4.5%
20 yrs & within 30 yrs	0%	35%	3.7%
30 yrs & within 40 yrs	0%	35%	33.8%
40 yrs & within 50 yrs	0%	50%	31.2%
50 yrs & above	0%	50%	0.0%

15.6. Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

15.7. **Principal Sums Invested for Periods Longer than 364 days:** The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. Given the policy of spending down cash balances and use of internal borrowing the Council does not expect to invest beyond 364 days in the medium term.

Appendix 1: Treasury & Prudential Indicators

No.	Prudential Indicator	2016/17 Original Indicator	2016/17 Outturn Position
CAPITAL INDICATORS			
1	Capital Expenditure	£'000	£'000
	General Fund	50,682	55,321
	HRA	64,307	58,210
	TOTAL	114,989	113,531

2	Ratio of financing costs to net revenue stream	%	%
	General Fund	1.93	1.86
	HRA	8.88	8.50

3	Capital Financing Requirement	£'000	£'000
	General Fund	290,670	304,119
	HRA	293,002	271,096
	TOTAL	583,672	575,215

4	Incremental impact of capital investment decisions	£	£
	Band D Council Tax	32.04	10.84
	Weekly Housing rents	1.51	0.09

5	Borrowing Limits	£'000	£'000
	Authorised Limit / actual debt	528,231	347,046
	Operational Boundary/actual debt	472,772	347,046

No.	Prudential Indicator	2016/17 Original Indicator	2016/17 Outturn
6	HRA Debt Cap	£'000	£'000
	Headroom	44,235	56,442

7	Gross debt compared to CFR	£'000	£'000
	Gross debt	312,233	347,046
	CFR	583,672	575,215

8	Upper limit – fixed rate exposure	100%	94%
	Upper limit – variable rate	40%	6%

9	Maturity structure of borrowing (U: upper, L: lower)	**L**	**U**	**31-Mar-17**
	under 12 months	0%	40%	4.5%
	12 months & within 2 years	0%	35%	3.9%
	2 years & within 5 years	0%	35%	10.4%
	5 years & within 10 years	0%	35%	8.0%
	10 yrs & within 20 yrs	0%	35%	4.5%
	20 yrs & within 30 yrs	0%	35%	3.7%
	30 yrs & within 40 yrs	0%	35%	33.8%
	40 yrs & within 50 yrs	0%	50%	31.2%
	50 yrs & above	0%	50%	0.0%

10	Sums invested for > 364 days	£0	£0

11	Adoption of CIPFA Treasury Management Code of Practice	√	√

12	**LOBO Adjusted** Maturity structure of borrowing (U: upper, L: lower)	L	U	**31-Mar-17**
	under 12 months	0%	40%	32.1%
	12 months & within 2 years	0%	35%	22.3%
	2 years & within 5 years	0%	35%	10.4%
	5 years & within 10 years	0%	35%	8.0%
	10 yrs & within 20 yrs	0%	35%	4.5%
	20 yrs & within 30 yrs	0%	35%	0.0%
	30 yrs & within 40 yrs	0%	35%	19.1%
	40 yrs & within 50 yrs	0%	50%	3.6%
	50 yrs & above	0%	50%	0.0%

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