Annual Treasury Management Report 2016/17

1. Introduction

This 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).

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

- an annual treasury strategy in advance of the year (Council 18/07/2017)
- a mid-year (minimum) treasury update report (Council 13/12/2016)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

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.

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 Governance and Audit Committee before they were reported to the full Council..

2.1 The Economy and 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 4 August meeting, 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.

2.2 Overall Treasury Position as at 31 March 2017

At the beginning and the end of 2016/17 the Council's treasury (including borrowing by PFI and finance leases) position was as follows:

TABLE 1	31 March 2016 Principal	31 March 2017 Principal
Borrowing	**£336m**	**£336m**
PFI and other finance leases	**£195m**	**£186m**
Total debt	**£531m**	**£522m**
CFR	**£666m**	**£653m**
Over / (under) borrowing	**(£135m)**	**(£131m)**
Total investments	**£43m**	**£50m**
Net debt	**£488m**	**£472m**

2.3 The Strategy for 2016/17

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 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.

In this scenario, the treasury strategy was to borrow the amount maturing this year which was £25.9m.

During 2016/17 there was major volatility in PWLB rates with rates falling during quarters 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.

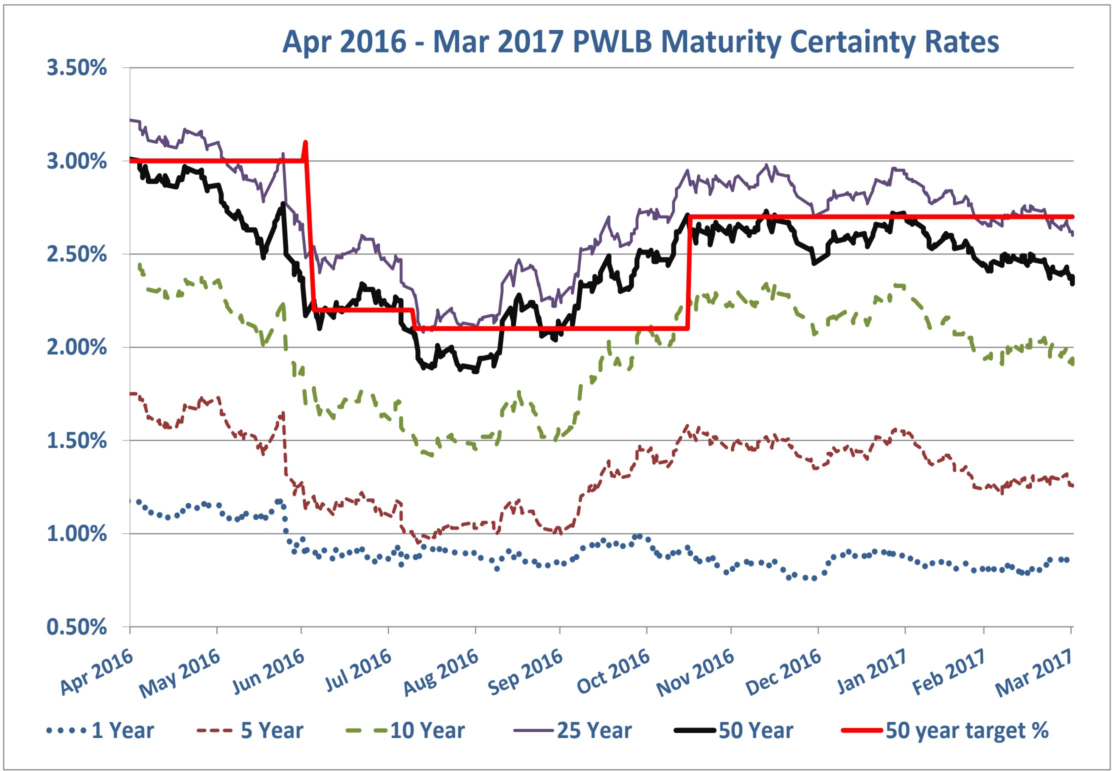
2.4 The Borrowing Requirement and Debt

The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR). The CFR represents the sum of historic borrowing required to fund the Councils capital investment less any provision made for the repayment of that debt through the Minimum Revenue Provision (MRP).This does not necessarily equate to external borrowing as the Council can use its own cash balances to fund its borrowing requirements. Where this occurs it is sometimes referred to as being "under borrowed" as if those cash balances are exhausted the Council would need to go out and borrow externally.

	31 March 2016 Actual	31 March 2017 Budget	31 March 2017 Actual
Capital Financing Requirement	£666m	£719m	£653m

2.5 Borrowing Rates in 2016/17

PWLB certainty maturity borrowing rates - the graph below shows how PWLB certainty rates have fallen to historically very low levels during the year.



2.6 Borrowing Outturn for 2016/17

Borrowing – the following loans were taken during the year: to replace loans totalling £26m in March 2017.

Lender	Principal £m	Type	Interest Rate	Maturity
PWLB	6.5	Fixed interest rate	2.610%	45 years
PWLB	2.0	Fixed interest rate	2.610%	46 years
PWLB	6.5	Fixed interest rate	2.610%	48 years
PWLB	3.0	Fixed interest rate	2.610%	47 years
PWLB	2.5	Fixed interest rate	2.630%	44 years
PWLB	1.4	Fixed interest rate	2.620%	44 years
PWLB	4.0	Fixed interest rate	2.620%	46 years

The level of underborrowing increased over the last two years and a decision was made in December to take advantage of currently low interest rates to borrow against loans maturing in March 2017. Loans to the value of £25.9m were therefore taken out at an average rate of 2.6187% and replaced loans of the same amount maturing in March, that have a average rate of 8.947%. This will reduce the average interest rate on the overall debt portfolio by 0.5% in March 2017, saving £1.65m per year.

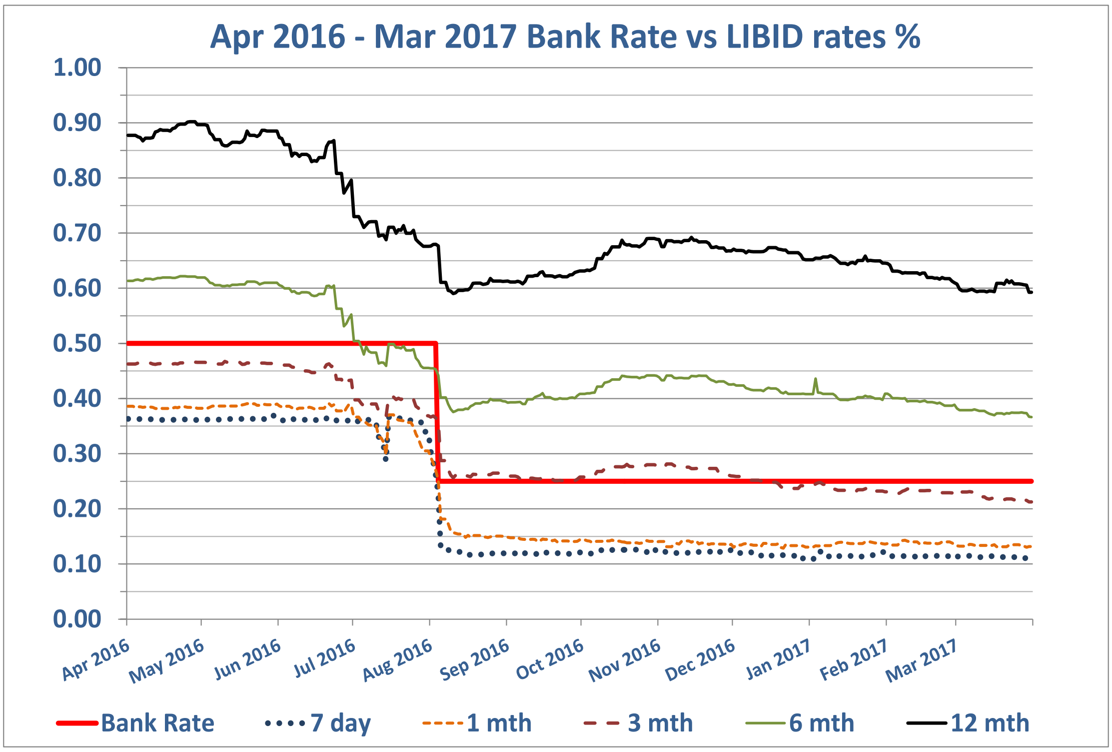
Rescheduling

No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

Repayments
On 10/03/17 the Council repaid £25.9m at an average rate of 8.947%

2.7 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 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.



2.8 Investment Outturn for 2016/17

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 18/07/2017. 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, bank share prices etc.).

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

Investments held by the Council - the Council maintained an average balance of £73.1m of internally managed funds. The internally managed funds earned an average rate of return of 0.44%.This compares with a budget assumption of £85m investment balances earning a rate of 0.6%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.20%.

2.9 Other Issues

None

3. Other considerations

None

4. Financial and Resources Appraisal

The financial implications are set out in section 2 of this report

5. Risk Management and Governance Issues

The principal risks associated with treasury management are:
Risk: Loss of investments as a result of failure of counterparties
Mitigation: Limiting the types of investment instruments used, setting lending criteria for counterparties, and limiting the extent of exposure to individual counterparties
Risk: Increase in the net financing costs of the authority due to borrowing at high rates of interest
Mitigation: Planning and undertaking borrowing and lending in light of assessments of future interest rate movements, and by undertaking mostly long term borrowing at fixed rates of interest (to reduce the volatility of capital financing costs).

6. Legal Appraisal

Any relevant legal considerations are set out in the report

7. Other Implications

7.1Equal & Diversity implications-no direct implications

7.2Sustainability implications-no direct implications

7.3Green house Gas Emissions Impacts-no direct implications

7.4Community safety implications-no direct implications

7.5 Human Rights Act –no direct implications

7.6 Trade Unions-no direct implications

7.7Ward implications –no direct implications

8. Not for publications documents – none

9. Options

None

10. Recommendations

10.1 That the report be noted and referred to council for adoption

11.Appendices

1.Prudential Indicators
2.Treasury Management Indicators
3.Appendix Graphs

12. Background Documents

Treasury Management Practices
Treasury Management Schedules

Appendix 1: Prudential and treasury indicators

1. PRUDENTIAL INDICATORS	2015/16 Actual £m	2016/17 Original £m	2016/17 Actual £m
Capital Expenditure	£70m	£133m	£61.5m
Ratio of financing costs to net revenue stream	16.0%	14.8%	15.9%
Gross borrowing requirement General Fund	£336m	£338m	£335m
Capital Financing Requirement	£666m	£719m	£653m
Incremental impact of capital investment decisions	**£ p**	**£ p**	**£ p**
Increase in council tax (band D) per annum	£0.00	£0.00	£0.00

2. TREASURY MANAGEMENT INDICATORS	**2015/16 actual £m**	**2016/17 original £m**	**2016/17 Actual £m**
Authorised Limit for external debt -			
borrowing	£336m	£400m	£336m
other long term liabilities	£195m	£240m	£186m
TOTAL	£531m	£640m	£522m
Operational Boundary for external debt -			
borrowing	£336m	£380m	£336m
other long term liabilities	£195m	£220m	£186m
TOTAL	£531m	£600m	£522m
Upper limit for fixed rate exposure	175 %	175 %	175%
Upper limit for variable rate exposure	+20%	+20 %	+20 %
Upper limit for total principal sums invested for over 364 days (per maturity date)	£0m	£20m	£0m

Maturity structure of fixed rate borrowing during 2016/17	upper limit	lower limit
under 12 months	20%	0%
12 months and within 24 months	20%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	50%	0%
10 years and within 20 years	50%	0%
20 years and within 30 years	90%	0%
30 years and within 40 years	90%	0%
40 years and within 50 years	90%	0%

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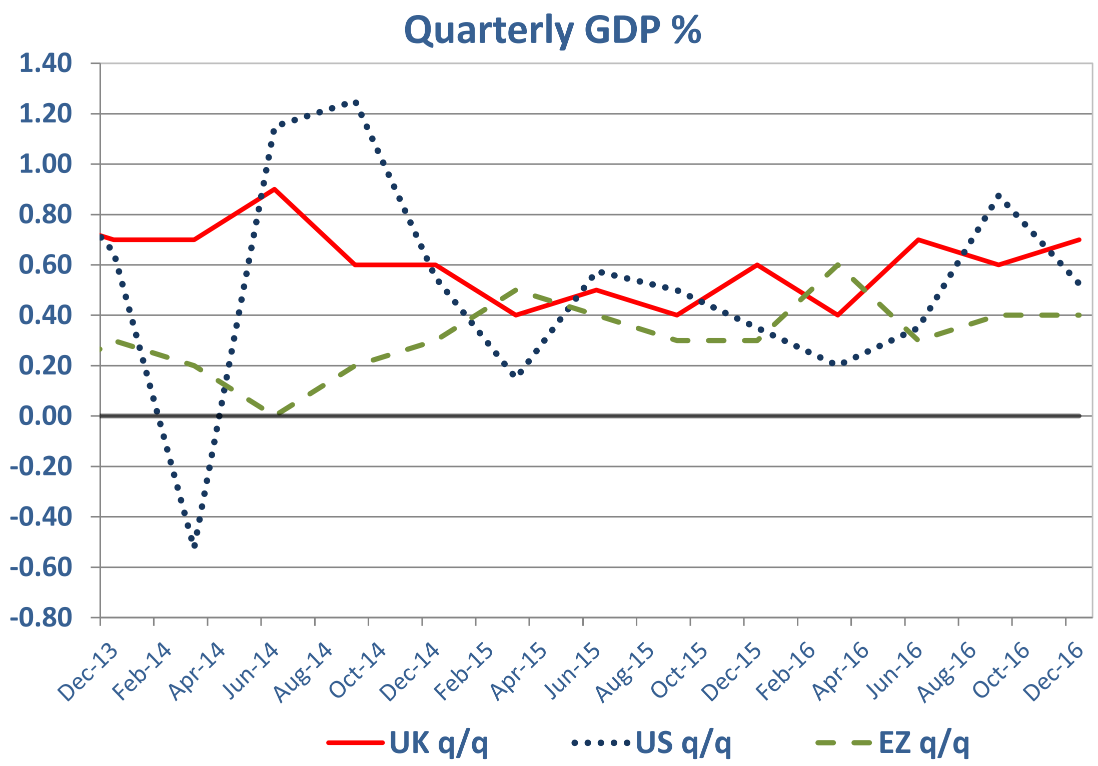
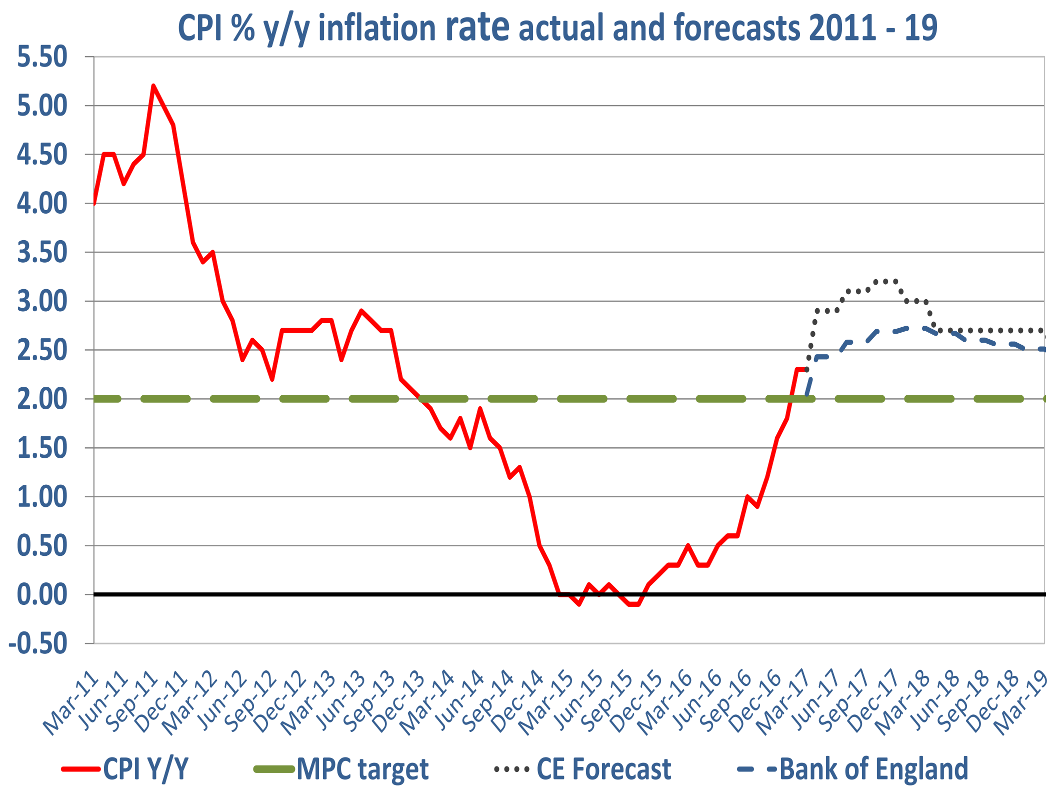
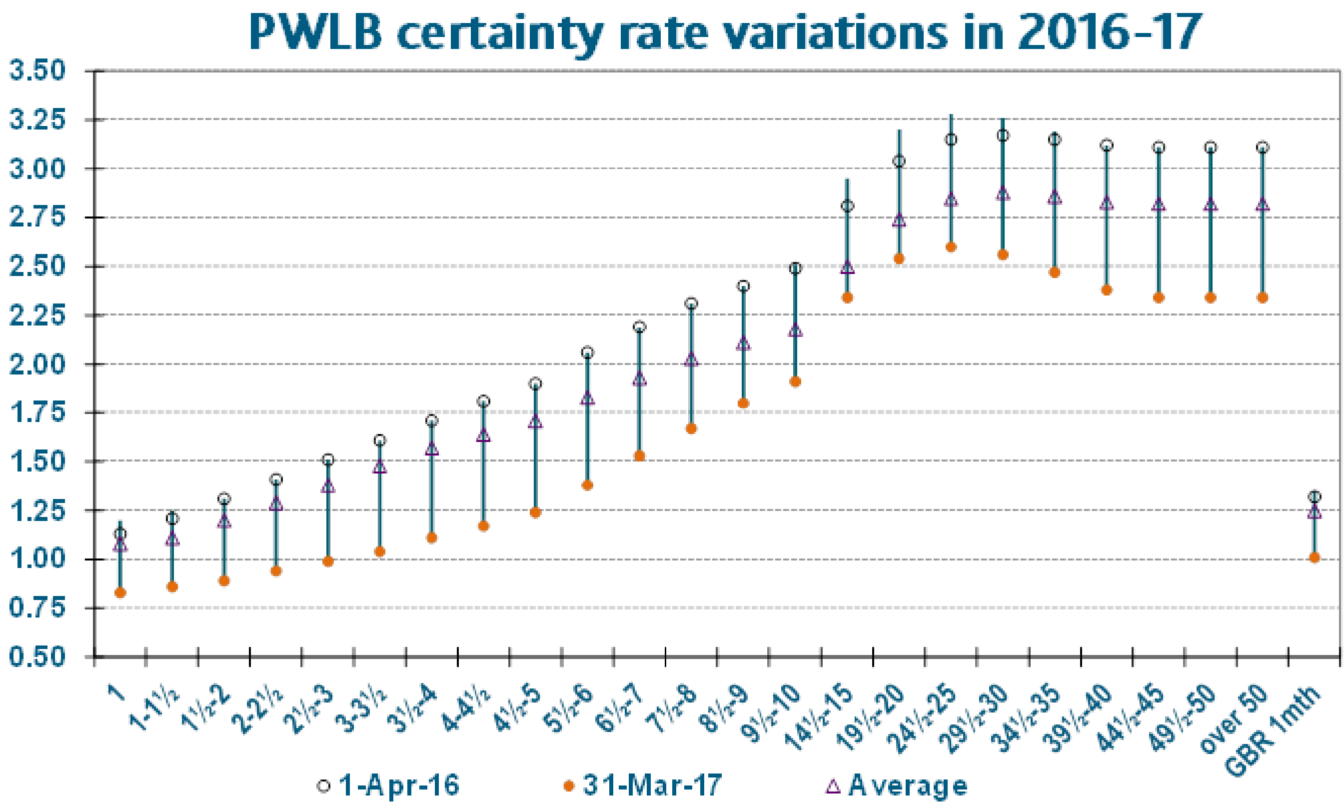
Appendix 3: Graphs







	1	1-1.5	2.5-3	3.5-4	4.5-5	9.5-10	24.5-25	49.5-50	1 month variable
1/4/16	1.130%	1.160%	1.330%	1.470%	1.620%	2.310%	3.140%	2.950%	1.310%
31/3/17	0.830%	0.860%	0.990%	1.110%	1.240%	1.910%	2.600%	2.340%	1.010%
High	1.200%	1.250%	1.460%	1.630%	1.800%	2.510%	3.280%	3.080%	1.350%
Low	0.760%	0.800%	0.840%	0.880%	0.950%	1.420%	2.080%	1.870%	1.040%
Average	0.928%	0.961%	1.104%	1.226%	1.361%	2.007%	2.724%	2.494%	1.150%
Spread	0.440%	0.450%	0.620%	0.750%	0.850%	1.090%	1.200%	1.210%	0.310%
High date	27/04/2016	27/04/2016	27/04/2016	27/04/2016	27/04/2016	27/04/2016	27/04/2016	27/04/2016	20/05/2016
Low date	20/12/2016	15/03/2017	10/08/2016	10/08/2016	10/08/2016	10/08/2016	12/08/2016	30/08/2016	30/11/2016

	1 Year	5 Year	10 Year	25 Year	50 Year
1/4/16	1.13%	1.62%	2.31%	3.14%	2.95%
31/3/17	0.83%	1.24%	1.91%	2.60%	2.34%
Low	0.76%	0.95%	1.42%	2.08%	1.87%
Date	20/12/2016	10/08/2016	10/08/2016	12/08/2016	30/08/2016
High	1.20%	1.80%	2.51%	3.28%	3.08%
Date	27/04/2016	27/04/2016	27/04/2016	27/04/2016	27/04/2016
Average	0.93%	1.36%	2.01%	2.72%	2.49%

Money market investment rates 2016/17

	7 day	1 month	3 month	6 month	1 year
1/4/16	0.363	0.386	0.463	0.614	0.877
31/3/17	0.111	0.132	0.212	0.366	0.593
High	0.369	0.391	0.467	0.622	0.902
Low	0.107	0.129	0.212	0.366	0.590
Average	0.200	0.220	0.315	0.462	0.702
Spread	0.262	0.262	0.255	0.256	0.312
High date	27/5/16	21/6/16	10/5/16	22/4/16	26/4/16
Low date	28/12/16	21/12/16	30/3/17	31/3/17	10/8/16