

# Annual Treasury Management Report 2016/17

as at 25/5/17 - LT



## **1. Introduction and Background**

This Council is required through regulations issued under the Local Government Act 2003 to produce an annual treasury report reviewing treasury management 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 - February 2016)
- a mid year (minimum) treasury update report (Council – December 2016)
- an annual report following the year describing the activity compared to the strategy (this report)

In addition, the Cabinet has received quarterly treasury management updates as part of the overall financial reporting during the course of the year.

The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is 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 also confirms that it has complied with the requirement under the Code to give prior scrutiny of treasury management reports by the Audit Committee before they were reported to the full Council.

## **2. This Annual Treasury Report Covers**

- the council's treasury position as at 31 March 2017;
- the strategy for 2016-17 – a summary;
- Borrowing and Investments outturn
- the economy and interest rates in 2016-17;
- compliance with treasury limits and prudential indicators;
- Icelandic bank defaults and other issues.

### 3. Treasury Position as at 31 March 2017

The council's debt and investment portfolio is organized by the financial management service in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks with all treasury management activities. Procedures and controls to achieve these objectives are well established through member reporting detailed in the introduction, and through officer activity detailed in the council's treasury management practices.

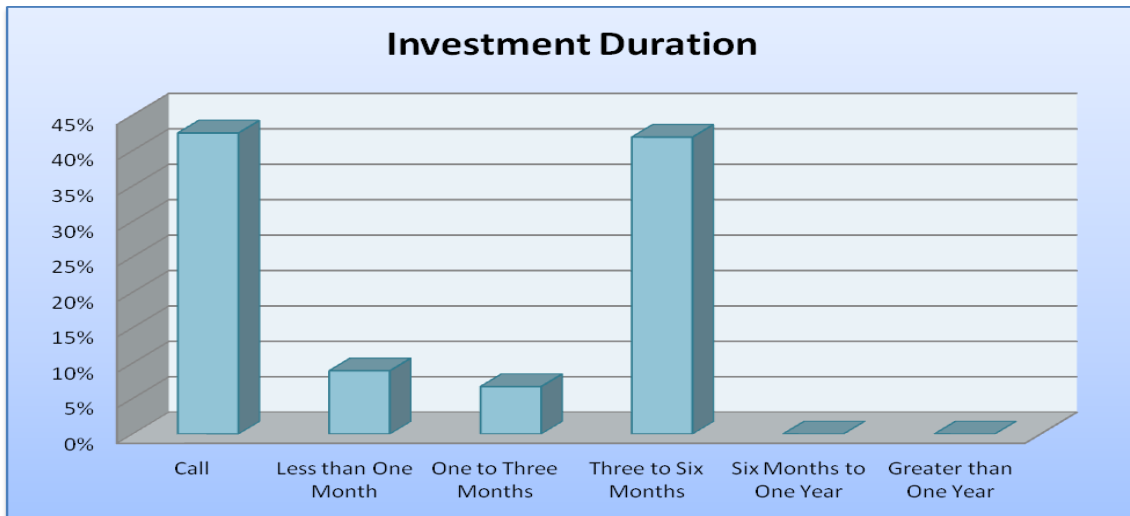
The council's treasury portfolio position (excluding borrowing from finance leases) and the average interest rates on the portfolio as at the beginning and end of the year were as follows:

2015/16 Principal	Average Rate		2016/17 Principal	Average Rate
<u>Borrowing</u>				
£6.5m		- PWLB	£6.4m	
£5.0m		- Market and other	£5.0m	
<b>£11.5m</b>	<b>5.4%</b>	<b>Total Borrowing</b>	<b>£11.4m</b>	<b>5.4%</b>
<u>Investments</u>				
£17.8m	<b>0.7%</b>	Core Deposits	£22.7m	<b>0.5%</b>
-		Forward Deposit (RBS)	£3.0m	
(£0.5m)		Cash and Bank	(£0.3m)	
<b>£17.3m</b>		<b>Total Investments</b>	<b>£25.4m</b>	

The maturity structure of the **borrowing** was as follows:-

2015/16 Principal		2016/17 Principal
£0.6m	Under 1 Year	£0.6m
£0m	Maturing in 1-2 Years	£0m
£0.2m	Maturing in 2-5 Years	£0.2m
£6.9m	Maturing in 5-10 Years	£6.9m
£3.8m	Maturing in 10-15 Years	£3.7m
£0m	Maturing in excess of 15 Years	£0m
<b>£11.5m</b>	<b>Total</b>	<b>£11.4m</b>

The maturity structure of the **investments at 31<sup>st</sup> March** was as follows:-



#### 4. The Strategy for 2016-17 - Summary

The Treasury Management Strategy Statement and Annual Investment Strategy for 2016/17 was approved by the Council on 22nd February 2016.

The expectation for interest rates within the treasury management strategy for 2016/17 anticipated low but rising Bank Rate (starting in quarter 2 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.

In this scenario, the treasury management strategy was to operate an under borrowed or internally borrowed position, postponing external borrowing to avoid the cost of holding higher levels of investments and to reduce counterparty risk.

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.

## 5. Borrowing Outturn for 2016/17

### 5.1 Capital Financing Requirement

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 debt position. The CFR results from the capital activity of the council and what resources have been used to pay for the capital spend. It represents unfinanced capital expenditure as at the year end.

The council's CFR is not allowed to rise indefinitely. Statutory controls are in place that require the authority to make an annual revenue charge, called the Minimum Revenue Provision (MRP) to reduce the CFR. This is effectively a repayment of non-housing borrowing.

The council's 2016/17 MRP policy (as required by DCLG guidance) was approved as part of the Treasury Management Strategy Statement for 2016/17. The CFR position is set out in the table below:-

<b>CFR</b>	<b>2016/17 Actual £'000</b>	<b>2015/16 Actual £'000</b>
Opening Balance	20,821	20,744
Add unfinanced capital expenditure	53	2,885
Less MRP	(441)	(509)
Less Debt Repayment	(1,333)	(1,540)
Less finance lease repayments	(542)	(664)
Change in long term debtors	37	(95)
<b>Closing Balance</b>	<b>18,595</b>	<b>20,821</b>

The mid-year update estimated that the CFR would be £18.2m as at 31<sup>st</sup> March 2017. This assumed repayment of the loan (£0.375m) from the GBSLEP, which is now likely to take place during 2017/18.

Overall the CFR has reduced by £2.2m, which is largely as a result of in year statutory repayments and the decision to repay £1.3m of debt in June 2016.

The Council's borrowing activity is constrained by affordability, and prudential indicators including the CFR, operational boundary and the authorised limit.

## 5.2 The Authorised Limit and Operational Boundary

The authorised limit is the “affordable borrowing limit” required by Section 3 of the Local Government Act 2003. The Council does not have the power to borrow above this level. The table below demonstrates that during 2016/17 the council has maintained gross borrowing within its authorised limit.

The operational boundary level is set at £21.5m to allow some headroom. Periods where the actual position is either above or below the boundary are acceptable subject to the authorised limit not being breached.

2015/16 £'000	Borrowing Limits and Boundaries	2016/17 £'000
23,500	Authorised Limit	23,500
21,500	Operational Boundary	21,500
13,958	Gross Borrowing at 31 <sup>st</sup> March (inc, Finance Leases)	13,349
11,527	Gross Borrowing at 31 <sup>st</sup> March (excl. Finance leases)	11,460
20,821	Capital Financing Requirement	18,595

## 5.3 Short-term Borrowing

It was anticipated that only very limited short-term borrowing would be required to cover temporary cash flow deficits; interest payable would therefore be minimal. No short term borrowing has been necessary during 2016/17.

## 5.4 Debt Re-scheduling

Debt rescheduling opportunities have been limited in the current economic climate and consequent structure of interest rates. There has not been any restructuring undertaken during 2016/17.

## 6. Investments Outturn 2016/17

### 6.1 Investment Policy

The Council's investment policy is governed by DCLG guidance, which has been implemented in the annual investment strategy approved by the Council in February 2016. The policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit agencies supplemented by additional market data (such as credit outlooks, credit default swaps, bank share prices).

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

### 6.2 Investments as at 31<sup>st</sup> March 2017

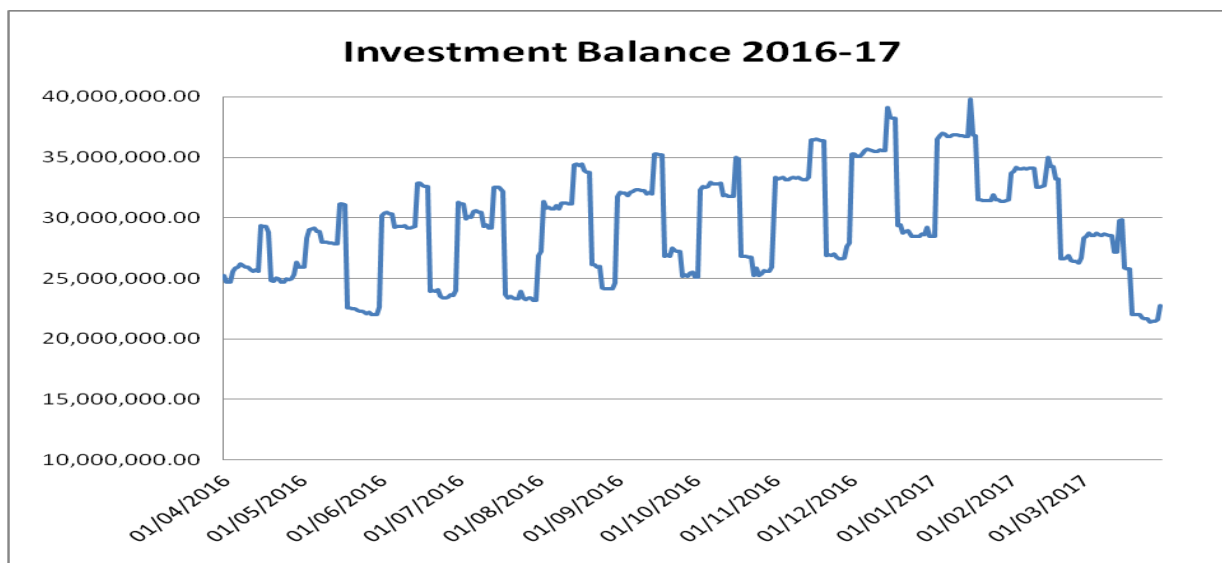
The Council's core investments during 2016/17 have increased to £25.4m. These balances were, in the main, held within AAA rated Money Market Funds and fixed term deposits amounting to £9.4m have also been placed with a few UK Banks offering rates above those provided by the business reserve accounts. This strategy reflects a continuation of the council's relatively low risk appetite in relation to its investments, but also the limited availability of attractive fixed term rates with suitable counterparties in the current economic climate.

The Council's Investments as at 31<sup>st</sup> March 2017 were:

Borrower	Principal (£)	Interest Rate	Start Date	Maturity Date
<b><u>Call Accounts and Money Market Funds</u></b>				
RBS SIBA	78,268	0.10%		Call
Standard Life MMF	4,000,000	0.23%		Call
Insight MMF	4,000,000	0.24%		Call
Federated MMF	1,450,000	0.23%		Call
Santander	3,500,000	0.65%		95 day notice
<b><u>Fixed Deposits:</u></b>				
Barclays	3,398,706	0.41%	21/02/2017	22/08/2017
BOS	1,500,000	0.55%	31/03/2017	29/09/2017
BOS	500,000	0.60%	04/05/2017	04/05/2017
BOS	500,000	0.65%	06/10/2016	06/04/2017
Lloyds TSB	1,000,000	0.60%	01/02/2017	01/08/2017
Lloyds TSB	1,500,000	0.65%	04/10/2016	04/04/2017
Lloyds TSB	1,000,000	0.60%	01/12/2016	01/06/2017

*\*a forward deal of £3m was placed with RBS on 29<sup>th</sup> March 2017 for settlement on 3<sup>rd</sup> April 2017 at a rate of 0.73% and maturity on 27<sup>th</sup> March 2018.*

The chart below illustrates the movement in the level of investments held by the Council throughout the year, with the peak being £39.8m in January and the average being £29m.



### 6.3 Investment Rates

The following table illustrates the rate of return generated by the Council's Investments for 2016/17, which compares favourably with the benchmark returns:

	Average Rate Year to 31/03/17
ESBC	0.50%
7 day LIBID Rate	0.21%
3 Month LIBID Rate	0.35%
Base Rate (Average)	0.33%
Budget	0.70%

\*\*LIBID = London Inter Bank Deposit Rate

The ESBC average return for the year exceeds the base rate and other benchmarks.

## 7. 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 the 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.

## 8. Compliance with Treasury Limits

During the financial year the Council operated within the treasury limits and Prudential Indicators set out in the Council's annual Treasury Strategy Statement. The outturn for the Prudential Indicators *is shown in Appendix 1*.

## 9. Icelandic Bank Defaults

This authority currently has the following investments outstanding in Icelandic banks:

Borrower - Icelandic Exposure				
Exposure	Principal (£)	Interest Rate	Start Date	Maturity Date
Singer	315,000	5.41%		08/10/2008

The administrators for Kaupthing, Singer and Friedlander Ltd made one dividend payment during the financial year. It is currently anticipated that the administration process will continue into 2018 (Current extension ends October 2018).

## Appendix 1: Prudential Indicators

PRUDENTIAL INDICATOR	2015/16	2016/17	2016/17
	£'000	£'000	£'000
	actual outturn	Original Estimate	actual outturn
<b>Capital Expenditure</b>	5,697	3,451	1,999
<b>Ratio of financing costs to net revenue stream</b>	11.70%	11.97%	12.97%
<b>Capital Financing Requirement as at 31 March (excluding finance leases)#</b>	18,390	17,598	16,706
<b>Capital Financing Requirement as at 31 March (including finance leases)</b>	20,821	17,598	18,595
<b>External Debt (excl. Finance leases)*</b>	11,530	11,087	11,460
<b>Incremental impact of capital investment decisions</b>	£ p	£ p	£ p
Increase in Council Tax (band D) per annum	0.10	0.05	0.08

# The outturn is lower than the original estimate due to the decision to repay debt of £1.3m during 2016/17 and the timing of the repayment of the GBSLEP loan now expected in 2017/18.

\*the original estimate assumed that the GBSLEP Loan in respect of Dove Way would be repaid in 2016/17. It is now likely that this will take place during 2017/18.

PRUDENTIAL INDICATOR	2015/16	2016/17	2016/17
<b>(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
	<b>actual outturn</b>	<b>original</b>	<b>actual outturn</b>
<b>Authorised Limit for external debt -</b>			
borrowing	<b>21,500</b>	21,500	<b>21,500</b>
other long term liabilities*	<b>2,000</b>	2,000	<b>2,000</b>
TOTAL	<b>23,500</b>	<b>23,500</b>	<b>23,500</b>
<b>Operational Boundary for external debt -</b>			
Borrowing	<b>19,500</b>	19,500	<b>19,500</b>
other long term liabilities*	<b>2,000</b>	2,000	<b>2,000</b>
TOTAL	<b>21,500</b>	<b>21,500</b>	<b>21,500</b>
<b>Upper limit for fixed rate exposure</b>	9,000	9,000	<b>9,000</b>
<b>Upper limit for variable rate exposure</b>	4,000	4,000	<b>4,000</b>
<b>Upper limit for total principal sums invested for over 1 year</b>	2,500	3,000	<b>3,000</b>

\*This provides an allowance for on-balance sheet finance leases, as set out in previous reports.

<b>Maturity structure of new fixed rate borrowing during 2016/17</b>	upper limit	lower limit
under 12 months	85%	0%
12 months and within 24 months	85%	0%
24 months and within 5 years	85%	0%
5 years and within 10 years	90%	0%
10 years and above	100%	0%