Treasury Management Outturn Report 2016/17

Introduction

The Council has adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition* (the CIPFA Code) which requires the Council to approve a treasury management annual report after the end of each financial year.

This report fulfils the Councils legal obligation to have regard to the CIPFA Code.

The Council's treasury management strategy for 2016/17 was approved at a meeting of the Authority on 25th February 2016. The Authority has invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Authority's treasury management strategy.

External Context

Economic background: 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.

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.

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.

Financial markets: 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.

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: 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.

None of the banks on the Council’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.

Local Context

On 31st March 2017, the Authority had net borrowing of £98.2m arising from its revenue and capital income and expenditure, a decrease on 2016 of £14.3m. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors and the year-on-year change are summarised in table 1 below.

Table 1: Balance Sheet Summary

	31.3.16 Actual £000	2016/17 Movement £000	31.3.17 Actual £000
General Fund CFR	14,450	(467)	13,983
HRA CFR	136,404	(2,045)	134,359
Total	**150,854**	**(2,512)**	**148,342**
Less: Usable reserves	(33,852)	(6,080)	(39,932)
Less: Working capital	(4,484)	(5,699)	(10,183)
Net borrowing	**112,518**	**(14,291)**	**98,227**

Net borrowing has decreased due to a fall in the CFR as new capital expenditure was lower than the financing applied including minimum revenue provision; together with an increase in usable reserves, especially due to £4.5m in the HRA working balance and £2.8m in the Capital Receipts Reserve; and a rise in working capital due to the timing of receipts and payments.

The Authority's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low. The treasury management position as at 31st March 2017 and the year-on-year change in show in table 2 below.

Table 2: Treasury Management Summary

	31.3.16 Balance £000	2016/17 Movement £000	31.3.17 Balance £000	31.3.17 Rate %
Long-term borrowing Short-term borrowing	135,159 2,500	1,914 2,500	133,245 0	
Total borrowing	**137,659**	**4,414**	**133,245**	**3.91%**

Long-term investments Short-term investments Cash and cash equivalents	3,270 9,024 12,847	(14) 6,145 3,746	3,256 15,169 16,593	
Total investments	**25,141**	**9,877**	**35,018**	**0.88%**
Net borrowing	**112,518**	**14,291**	**98,227**	

The decrease in net borrowing in table 1 has translated into a rise in investment balances due to the Authority's internal borrowing policy.

Borrowing Activity

At 31st March 2017, the Authority held £133m of loans, a decrease of £4m on the previous year, as part of its strategy for funding previous years' capital programmes. The year-end borrowing position and the year-on-year change in show in table 3 below.

Table 3: Borrowing Position

	31.3.16 Balance £m	**2016/17 Movement £m**	**31.3.17 Balance £m**	**31.3.17 Rate %**	**31.3.17 Average maturity years**
Public Works Loan Board	135,152	1,909	133,243	3.91	29 years
Local Authorities (short term)	2,500	2,500	0		
Other	7	5	2	6.25	1 year
Total borrowing	**137,659**	**4,414**	**133,245**		

The Authority's chief objective when borrowing has been to strike 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 Authority's long-term plans change being a secondary objective.

In furtherance of these objectives, no new borrowing was undertaken in 2016/17, while existing loans were allowed to mature without replacement. This strategy enabled the Authority to reduce net borrowing costs and reduce overall treasury risk.

The “cost of carry” analysis performed by the Authority’s treasury management advisor Arlingclose did not indicate any value in borrowing in advance for future years’ planned expenditure and therefore none was taken.

Investment Activity

The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During 2016/17, the Authority’s investment balance ranged between £26m and £53m million due to timing differences between income and expenditure. The year-end investment position and the year-on-year change in show in table 4 below.

Table 4: Investment Position

	31.3.16 Balance £m	2016/17 Movement £m	31.3.17 Balance £m	31.3.17 Rate %	31.3.17 Average maturity years
Banks & building societies (unsecured)	10.0	5.5	15.5	0.81	<1 year
Covered bonds (secured)	0	2.0	2.0	0.64	<1 year
Government (incl. local authorities)	3.3	0	3.3	1.25	1 year
Money Market Funds	11.8	2.4	14.2	0.59	<1year
Total investments	**25.1**	**9.9**	**35.0**		

Both the CIPFA Code and government guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority’s objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

In furtherance of these objectives, and given the increasing risk and falling returns from short-term unsecured bank investments, the Authority diversified into more secure and/or higher yielding asset classes during 2016/17.

Performance Report

The Authority measures the financial performance of its treasury management activities in terms of its impact on the revenue budget, as shown in table 6 below.

Table 6: Performance

	Actual £000	Budget £000	Over/ under
Total investment income	(334)	(318)	(16)
Total debt expense	5,303	5,298	5
GRAND TOTAL	4,969	4,980	(11)

Compliance Report

The Head of Finance and Resources is pleased to report that all treasury management activities undertaken during 2016/17 complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated in table 7 below.

Table 7: Investment Limits

	2016/17 Maximum	31.3.17 Actual	2016/17 Limit	Complied
Any single organisation	**£5m**	**£5m**	**£5m**	✓
Any group of funds under the same management	**£7.5m**	**£7.25**	**£7.5m**	✓
Enhanced Money Market Funds	**£14.1m**	**£10m**	**£15m**	✓

Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 8 below.

Table 8: Debt Limits

	2016/17 Maximum £000	31.3.17 Actual £000	2016/17 Operational Boundary £000	2016/17 Authorised Limit £000	Complied
Borrowing	**£137,659**	**£133,245**	**£137,660**	**£148,000**	✓

Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure. Total debt was above the operational boundary for the whole of 2016/17.

Treasury Management Indicators

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

Interest Rate Exposures: This indicator is set to control the Authority'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 was:

	31.3.17 Actual	2016/17 Limit	Complied
Upper limit on fixed interest rate exposure	57%	100%	✓
Upper limit on variable interest rate exposure	43%	50%	✓

Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or the transaction date if later. All other instruments are classed as variable rate.

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

	31.3.17 Actual	Upper Limit	Lower Limit	Complied
Under 12 months	0.01%	15%	0%	✓
12 months and within 24 months	0.01%	15%	0%	✓
24 months and within 5 years	4%	45%	0%	✓
5 years and within 10 years	10%	75%	5%	✓
10 years and above	85.98%	95%	25%	✓

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.

Principal Sums Invested for Periods Longer than 364 days: These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

	2016/17	2017/18	2018/19
Actual principal invested > 364 days	8%	0%	0%
Limit on principal invested > 364 days	25%	25%	25%
Complied	✓	✓	✓