Appendix A

Annual Treasury Management Review

2016/17

English Local Authorities

Annual Treasury Management Review 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 Full Council 10th February 2016
- a mid-year (minimum) treasury update report Full Council 14th December 2016
- an annual review following the end of the year describing the activity compared to the strategy (this report)

In addition, Members have received quarterly treasury management update reports as part of the Members' Newsletter.

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 Budget & Strategic Planning Working Group before they were reported to the Full Council.

2. 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.

3. Overall Treasury Position as at 31 March 2017

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

TABLE 1	31 March 2016 Principal £m	Rate/ Return	Average Life yrs	31 March 2017 Principal £m	Rate/ Return	Average Life yrs
Total debt	**31.413**	**3.72%**	**32**	**31.413**	**3.72%**	***32***
CFR	**31.622**			**31.610**		
Over / (under) borrowing	**(0.209)**			**(0.19)**		
Total investments	**17.650**	**0.67%**	**Under 1 yr**	**20.500**	**0.70%**	
Net debt	**13.763**			**10.913**		

4. The Strategy for 2016/17

The expectation for interest rates within the treasury management strategy for 2016/17 anticipated low but rising Bank Rate 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 postpone borrowing to avoid the cost of holding higher levels of investments and to reduce counterparty risk. However as anticipated no new borrowing during 2016-17.

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.

The strategy adopted in the original Treasury Management Strategy Report for 2016/17 approved at Full Council on 10th February 2016 was subject to revision during the year.

The following three amendments were approved in the mid year report approved at Full Council on 14th December 2016.

- Property Funds were added as an alternative investment option, enabling the diversification of the portfolio to maximise investment returns whilst maintaining security.
- The counterparty criteria was amended to allow any financial institutions with a colour coding on Capita Asset Services credit list to be considered for investment of up to 1 year.
- Specified investment criteria was re-worded from Money Market Funds to Pooled Investment Vehicles; this term includes Money Market Funds and Enhanced Cash Funds. The rating required for investment in these instruments remains at AAA by Standard and Poor's, Moody's and / or Fitch rating agencies.

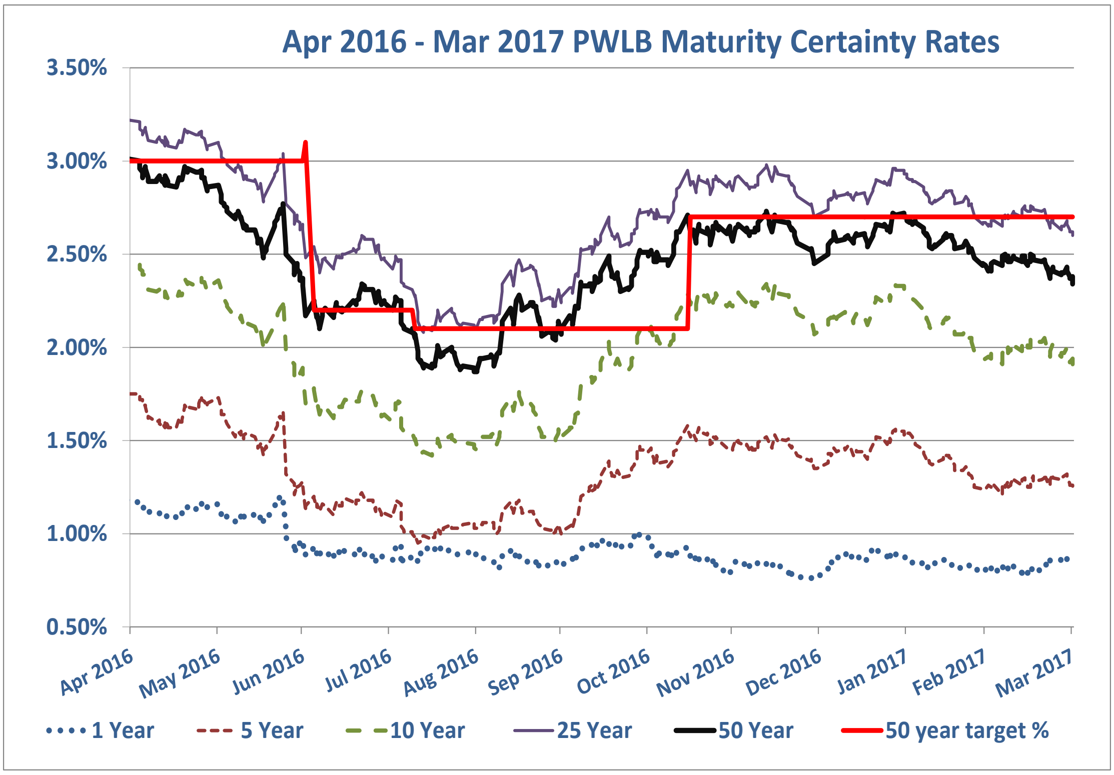
5. The Borrowing Requirement and Debt

The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).

	31 March 2016 Actual £m	31 March 2017 Budget £m	31 March 2017 Actual £m
CFR General Fund	0.138	0.126	0.126
CFR HRA	31.484	31.484	31.484
Total CFR	31.622	31.610	31.610

6. 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.



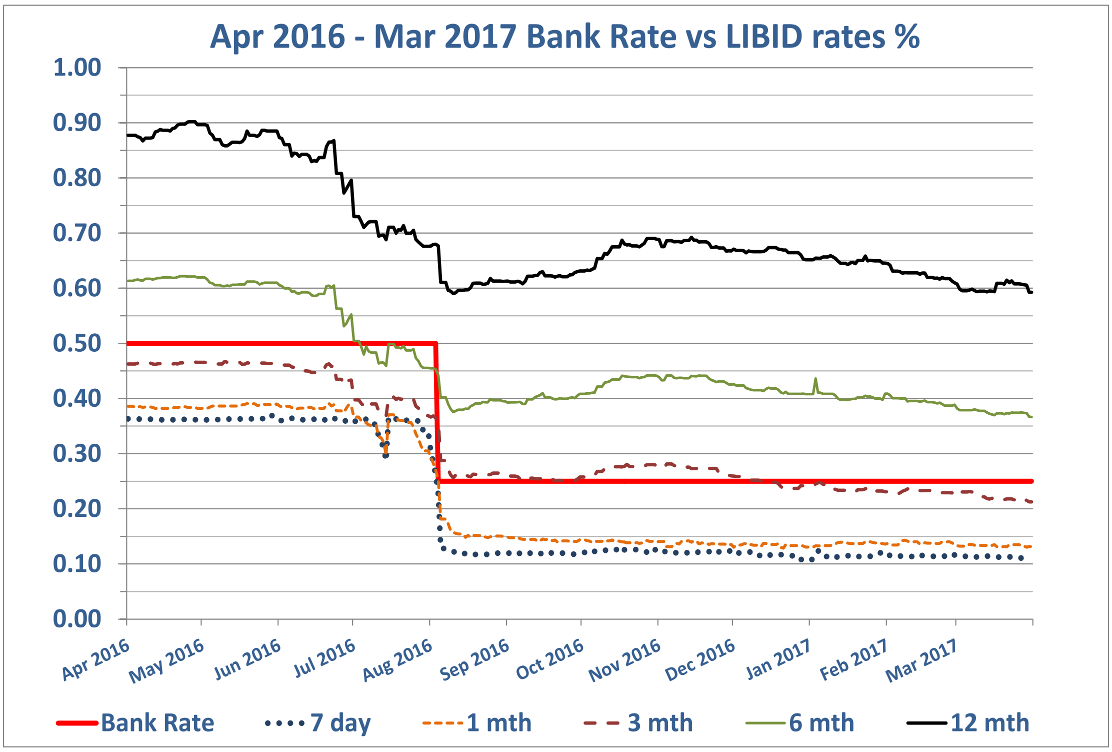
7. Borrowing Outturn for 2016/17

There were no borrowing requirements during 2016/17.

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

8. 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.



9. 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 10th 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, bank share prices etc.).

As detailed in section 4, three amendments were made to the strategy during 2016-17. Property Funds were added as an investment option. Counterparties with a colour coding on the Capita Asset Services credit list are now considered for investment for up to 1 year. Specified investment criteria was re-worded from Money Market Funds to Pooled Investment Vehicles; this includes Money Market Funds and Enhanced Cash Funds.

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 £22.5m of internally managed funds. The internally managed funds earned an average rate of return of 0.7%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.20%. This compares with a budget assumption of £14.7m investment balances earning an average rate of 0.65%.

The average rate achieved was higher than budgeted due to extending the length of the portfolio to fit liquidity requirements. The balances held were higher than budgeted and this resulted in £23.5k of additional income.

Appendix 1: Prudential and Treasury Indicators

During 2016/17, the Council complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

Actual prudential and treasury indicators	2015/16 Actual £m	2016/17 Original £m	2016/17 Actual £m
Capital expenditure • General Fund • HRA • Total	 1.971 1.475 3.446	 4.622 3.915 8.537	 5.009 1.746 6.755
Capital Financing Requirement: • General Fund • HRA • Total	 0.138 31.484 31.622	 0.126 31.484 31.610	 0.126 31.484 31.610
Gross borrowing	31.413	31.413	31.413
External debt	31.413	31.413	31.413
Investments • Longer than 1 year • Under 1 year • Total	Investments of £17.65m are for less than one year	Investments of £14.7m are for less than one year	Investments of £20.5m are for less than one year
Net borrowing	13.763	16.713	10.913

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2016/17) plus the estimates of any additional capital financing requirement for the current (2017/18) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs in 2016/17.

The authorised limit - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, 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 – 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.

Actual financing costs as a proportion of net revenue stream - this indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

	2016/17 £m
Authorised limit	46.000
Maximum gross borrowing position	31.413
Operational boundary	36.539
Average gross borrowing position	31.413
Financing costs as a proportion of net revenue stream- General Fund	-0.78%
Financing costs as a proportion of net revenue stream- HRA	13.67%

TABLE 1	31 March 2016 Principal £m	Rate/ Return	Average Life yrs	31 March 2017 Principal £m	Rate/ Return	Average Life yrs
Fixed rate funding:						
-PWLB	31.413	3.72%	32	31.413	3.72%	32
-Market	0	0%	0	0	0%	0
Variable rate funding:						
-PWLB	0	0%	0	0	0%	0
-Market	0	0%	0	0	0%	0
Total debt	**31.413**	**3.72%**	32	**31.413**	**3.72%**	32
CFR	**31.622**			**31.610**		
Over/ (under) borrowing	**(0.209)**			**(0.19)**		
Total investments	**17.650**	**0.61%**		**20.500**	**0.70%**	
Net debt	**13.763**			**10.910**		

The maturity structure of the debt portfolio was as follows:

	31 March 2016 Actual £m	31 March 2017 Actual £m
Under 5 years	0	0
5 years and within 10 years	2.098	4.098
10 years and within 20 years	2.600	0.600
20 years and within 30 years	5.000	10.000
30 years and within 40 years	10.840	10.840
40 years and within 50 years	10.875	5.875

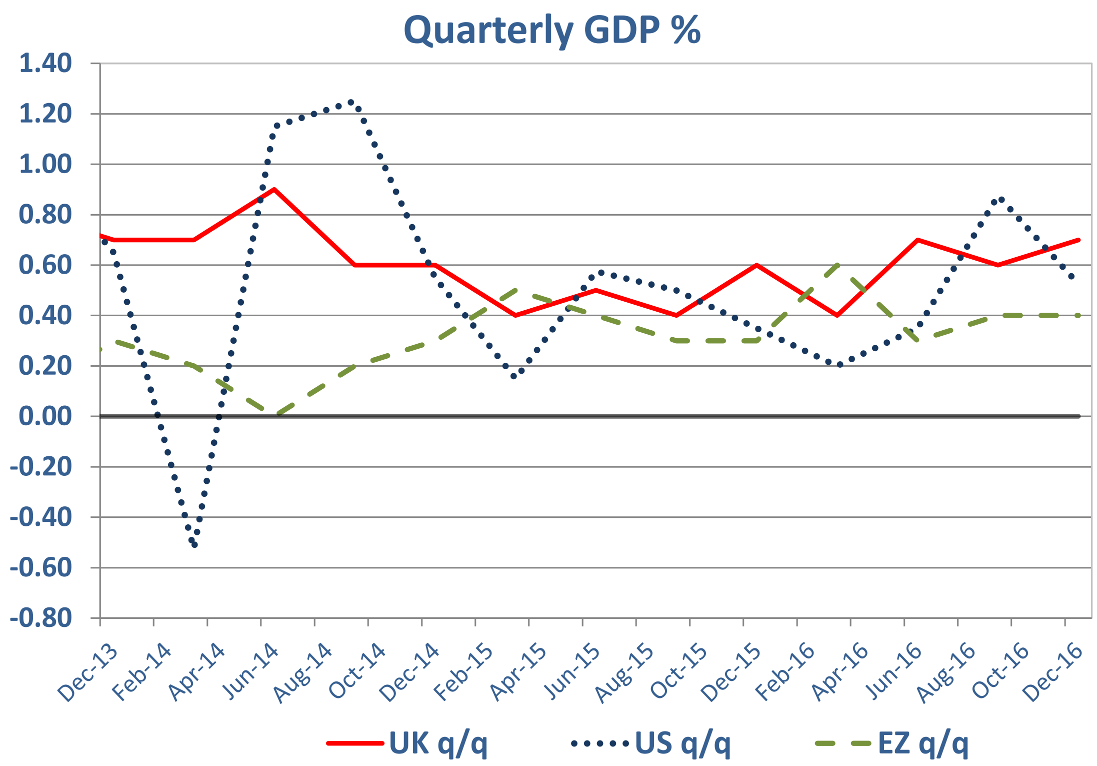
The maturity structure of the investment portfolio was as follows:

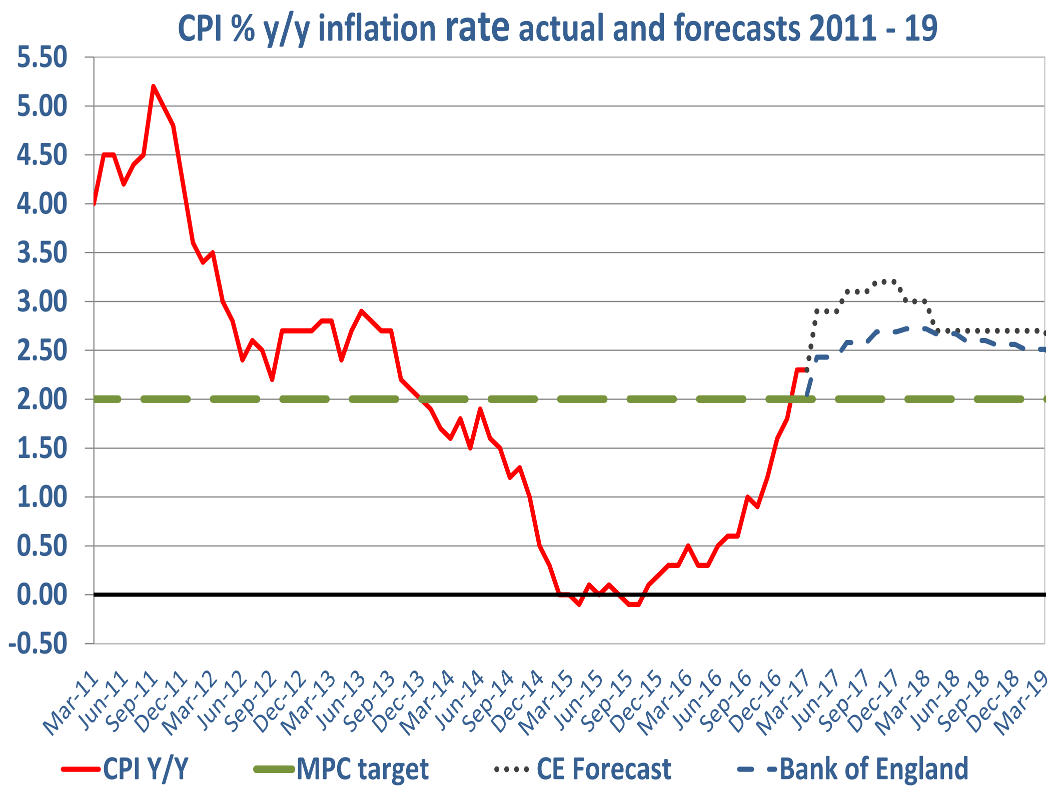
	2015/16 Actual	2016/17 Original	2016/17 Actual
Investments Under 1 year Total	Investments of £17.65m are for less than one year	Investments of £14.7m are for less than one year	Investments of £20.5m are for less than one year

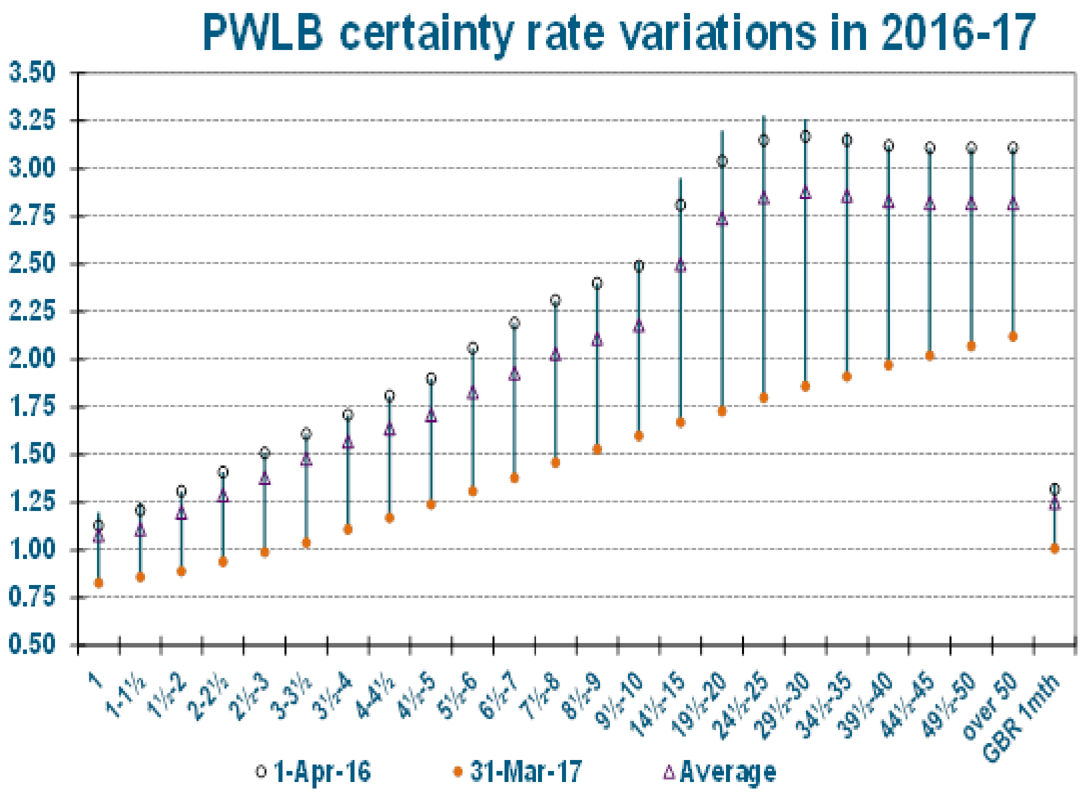
The exposure to fixed and variable rates was as follows:

	31 March 2016 Actual £m	2016/17 Original Limits £m	31 March 2017 Actual £m
Fixed rate (principal or interest) based on net debt	16.76	39	12.41
Variable rate (principal or interest) based on net debt	-3	7	-1.5
Limits on fixed interest rates based on net debt: • Debt only • Investments only	31.41 14.65	39	31.41 19
Limits on variable interest rates: • Debt only • Investments only	0 -3	7	0 -1.5

Appendix 2: 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%	1.600%	1.800%	2.070%	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%	1.60%	1.80%	2.07%
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%