TREASURY MANAGEMENT ANNUAL REPORT 2016/17

Finance Advisory Committee – 5 September 2017

Report of the: Chief Finance Officer

Status: For recommendation to Cabinet

Also considered by: Cabinet – 14 September 2017

Key Decision: No

Executive Summary: This report provides the customary review of investment activity during 2016/17 as required by the Council's Financial Procedure Rules. The report outlines the strategy adopted during the year, shows the position of the investment portfolio at the beginning and the end of the year and gives details of how the fund performed in comparison with previous years and against various benchmarks.

This report supports the Key Aim of Effective Management of Council Resources.

Portfolio Holder Cllr. John Scholey

Contact Officer Roy Parsons, Principal Accountant - Ext 7204

Recommendation to Finance Advisory Committee: That Cabinet be asked to approve the Treasury Management Annual Report for 2016/17.

Recommendation to Cabinet: That the Treasury Management Annual Report for 2016/17 be approved.

Reason for recommendation: As required by both the Council's Financial Procedure Rules and the CIPFA Code, an annual report of treasury management activity is to be presented to Members for approval.

Background

1 The 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 Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

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

- an annual treasury strategy in advance of the year (Council 16/2/2016)
- a mid year (minimum) treasury update report (Finance Advisory Committee 15/11/2016, Cabinet 1/12/2016)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

3 In addition, regular reports on progress were presented to the Finance Advisory Committee. The Council's treasury management advisers, Capita Asset Services Ltd, also provided monthly reviews of our investment performance which were forwarded to Members.

4 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.

5 This Council also confirms that it has complied with the requirement under the Code to give prior scrutiny to treasury management reports before they were reported to the full Council. Member training on treasury management issues was undertaken on 27 January 2010 in order to support Members' scrutiny role.

6 Members will be aware of the Property Investment Strategy which commenced in the latter part of 2014/15. The use of surplus cash balances for this type of 'Policy Investment' does not form part of the treasury management strategy and is not required to be included in either the Treasury Management Strategy Statement or the Annual Investment Strategy.

Introduction

7 This **annual treasury report** covers:

(a) The Council's treasury position at the beginning and end of the financial year;

(b) Investment Strategy for 2016/17;

(c) the economy and interest rates in 2016/17;

(d) compliance with treasury limits and prudential indicators;

(e) borrowing requirement and debt;

(f) investment rates in 2016/17;

(g) investment outturn for 2016/17 and performance; and

(h) an update on the Municipal Bonds Agency

Treasury position at the beginning and end of the financial year

8 The Council's investment portfolio at the beginning and end of the financial year appears at Appendix A, whilst an analysis by maturity and repayment due dates appears at Appendix B.

Investment Strategy for 2016/17

9 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.

10 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.

11 During 2016/17 there was major volatility in Public Works Loan Board (PWLB) rates, with rates falling during quarters 1 and 2 to reach historically very low levels in July and August 2016, before rising significantly during quarter 3, and then partially easing back towards the end of the year.

12 The strategy adopted in the original Treasury Management Strategy Report for 2016/17, approved by the Council on 16 February 2016, was not subject to revision during the year.

13 Counterparty credit ratings were kept under constant review to ensure that any investment decisions met minimum lending requirements.

The economy and interest rates in 2016/17

14 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 2016 and the election of President Trump in the USA on 9 November 2016. 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 Bank of England's 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.

15 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.

Compliance with treasury limits and prudential indicators

16 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:

	2015/16 Actual (£000)	2016/17 Original (£000)	2016/17 Actual (£000)
Capital expenditure	8,248	22,046	17,238
Total Capital Financing Requirement:			
• Non-HRA	-	-	-
• HRA	-	-	-
• Total	-	-	-
Net borrowing	-	-	-
External debt	-	-	-
Investments:			
• Longer than 1 year	3,000	-	-
• Under 1 year	31,420	-	29,320
• Total	34,420	-	29,320

17 The investment figures relate to the time left to maturity, not the length at the commencement date and exclude accrued interest.

18 During the year the Council operated within the treasury limits and prudential indicators set out in its Treasury Policy Statement and Annual Treasury Strategy Statement

19 The lending list was kept under constant review throughout the year in response to credit rating changes as and when they arose.

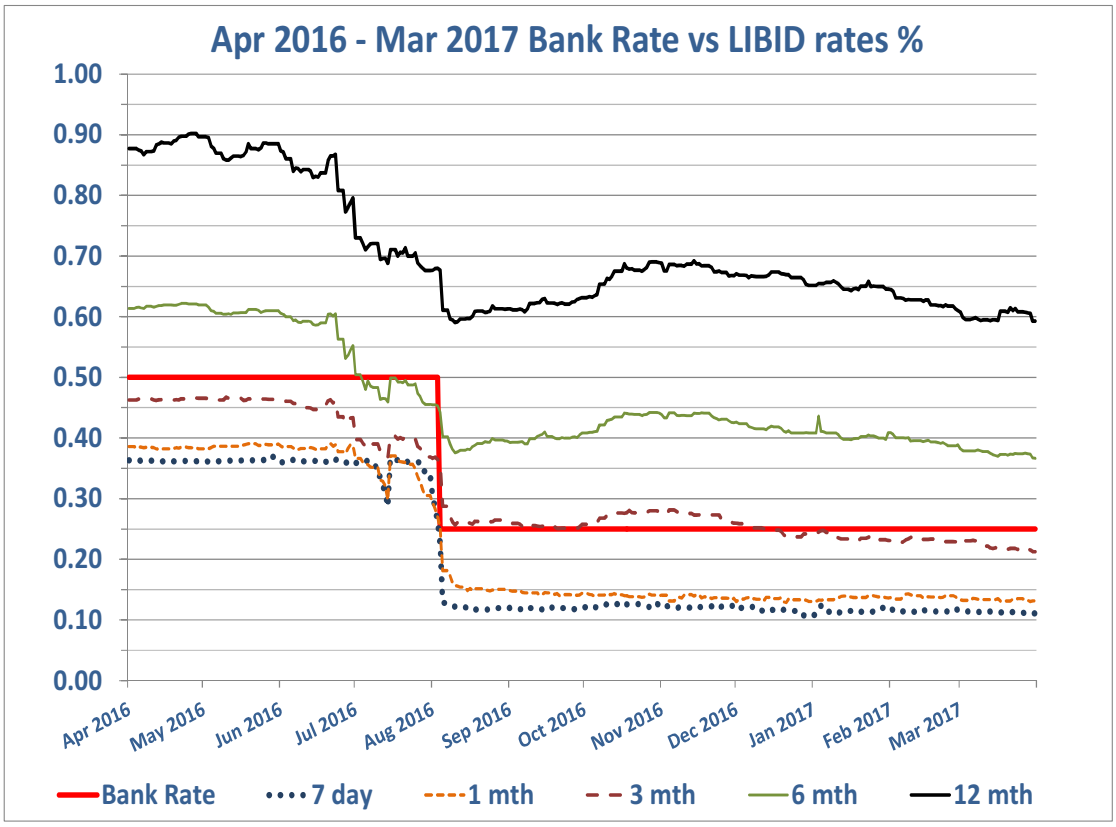
20 No institutions in which investments were made during 2016/17 had any difficulty in repaying investments and interest in full during the year.

The borrowing requirement and debt

21 The Council did not enter into any long-term borrowing during 2016/17 and has no debt. However, the Council's strategy permits temporary borrowing to meet overnight or short-term cashflow deficits and to facilitate the prudent and efficient management of the Council's treasury position. There was no temporary borrowing during 2016/17.

Investment rates in 2016/17

22 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.



Investment outturn for 2016/17 and performance

23 The Council's investment policy is governed by Department of Communities and Local Government (CLG) guidance, which has been implemented in the annual investment strategy approved by the Council on 16 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).

24 The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties, which might have led to the need to borrow.

25 Appendix C shows the performance of the fund during 2016/17 both in table and graphical form. The table shows the average percentage return on the fund, both monthly and for the whole year and compares them with the average 7-day and 3-month London Interbank Bid (LIBID) rates. The average return achieved by each broker is only a very basic measure of performance, because returns will depend on the number and length of each investment he/she is asked to carry out. If a particular broker is only asked to place short term investments, he/she may well not achieve the same overall rate as a broker who predominantly handles longer term investments for us.

26 The graph shows actual monthly receipts for 2014/15, 2015/16 and 2016/17 plus budgeted monthly receipts for 2016/17. The monthly interest budget

has been profiled in line with the previous year's monthly weighted average principal.

27 Over the course of the year interest receipts amounted to £237,700 compared with a budget of £277,000.

28 In 2016/17 the average return on the Council's investments was roughly in line with that of our neighbouring authorities. Our overall rate of return was 0.54% compared with 0.65% for Tonbridge & Malling Borough Council and 0.575% for Gravesham Borough Council. Dartford Borough Council's rate of return is not in the public domain, so I am unable to provide a comparison. It should be noted that investment returns are notoriously difficult to compare as they have often been compiled on a different basis (for example, whether or not interest has been compounded, whether or not cashflow generated balances have been included, whether or not externally managed funds have been included and whether or not the figures are net of borrowings).

29 Our treasury management advisers recommend the 3-month LIBID figure as a benchmark. This reflects a more realistic neutral investment position for core investments with a medium term horizon and a rate which is more stable with less fluctuation caused by market liquidity. Historically, this rate has been slightly higher than the 7-day rate and therefore more challenging a comparator, but one which does not necessitate a significantly increased level of risk. The figures calculated by our advisers for these two benchmarks are as follows:

- 7-day LIBID uncompounded 0.200%
- 3-month LIBID uncompounded 0.315%

Update on the Municipal Bonds Agency

30 During 2014/15, the Council invested £50,000 to become an equity shareholder in the Local Capital Finance Company, which was set up by the Local Government Association under the name of the Municipal Bonds Agency (MBA). This was a 'Policy Investment' and does not form part of the treasury management strategy. The purpose of the Agency is to facilitate borrowing by local authorities at rates that are expected to be more competitive than those of the Public Works Loan Board (PWLB). There are 56 shareholder councils.

31 The primary focus of the company has been delivering its first debt financing and has engaged with numerous authorities with regard to their debt finance requirements. The Agency has received a strong confidential credit rating and has had its "Framework Agreement" approved by at least 21 councils, who can now avail themselves of borrowing from the Agency.

32 The Agency is now working with a small cohort of authorities in order to deliver a proof of concept initial deal. It is anticipated that this deal will shortly be marketed to investors.

33 The objective of the MBA is to provide borrowing at lower rates than the PWLB Certainty Rates (i.e. gilts + 80 basis points).

34 The MBA has stressed that success or failure will depend on local authority take up of loans. The major sticking point has been the implementation of a joint and several liability clause in the Framework Agreement in the event that a borrowing local authority defaults on its loan. In these circumstances, the other borrowing authorities would be liable to make up the shortfall.

35 It is also the intention of the MBA to develop a platform for inter-authority borrowing between councils. They are looking to provide a platform that is more controlled, more transparent and cheaper than the PWLB.

36 There are no immediate plans to borrow from the MBA. However, should the need arise, Cabinet has given delegated authority to the Section 151 Officer and the Monitoring Officer to sign the Framework Agreement, as appropriate, on behalf of the Council.

Key Implications

Financial

37 The management of the Council's investment portfolio and cash-flow generated balances plays an important part in the financial planning of the authority. The security of its capital and liquidity of its investments is of paramount importance.

Legal Implications and Risk Assessment Statement

38 Under Section 151 of the Local Government Act 1972, the Section 151 Officer has statutory duties in relation to the financial administration and stewardship of the authority, including securing effective arrangements for treasury management.

39 This annual review report fulfils the requirements of The Chartered Institute of Public Finance & Accountancy's Code of Practice on Treasury Management 2009.

40 Treasury management has two main risks :

- Fluctuations in interest rates can result in a reduction in income from investments; and
- A counterparty to which the Council has lent money fails to repay the loan at the required time.

41 Consideration of risk is integral in our approach to treasury management. However, this particular report has no specific risk implications as it is not proposing any new actions, but merely reporting performance over the last year.

Equality Assessment

42 The decisions recommended through this paper have a remote or low relevance to the substance of the Equality Act. There is no perceived impact on end users.

Conclusions

43 The overall return on the Council's investments was below budget in 2016/17 by approximately £39,300. However, the percentage return exceeded the recognised benchmarks.

44 The economic situation both globally and within the Eurozone remains volatile, and this will have consequences for the UK economy. Treasury management in the past financial year was conducted against this background and with a cautious investment approach.

Appendices:

Appendix A – Investment portfolio at start and end of financial year

Appendix B – Analysis of investment portfolio by maturity and repayment due dates

Appendix C - Investment performance in 2016/17

Background Papers:

Treasury Management Strategy for 2016/17 - Council 16 February 2016

Adrian Rowbotham
Chief Finance Officer