BOROUGH COUNCIL OF WELLINGBOROUGH AGENDA ITEM 6

Resources Committee 29 June 2016

Report of Head of Finance

TREASURY MANAGEMENT OUTTURN - ANNUAL REPORT 2015-16

1 Purpose of Report

The purpose of this report is to present the annual report of treasury management activity for 2015-16. The treasury management function contributes towards the council's overall objective of the efficient use of resources.

2 Executive Summary

To inform members of the outturn position in respect of the application of the treasury management strategy for 2015-16.

3 Appendices

1. Prudential Indicators for the year 2015-16
2. Economic Overview

4 The Committee Is invited to RECOMMEND to:

4.1 NOTE the Treasury Management outturn position, as detailed in the report.

5 Background

5.1 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 2015-16. 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).

5.2 During 2015-16 the minimum reporting requirements were that the full Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 31 March 2015)
- a mid-year treasury update report (Council 1 December 2015)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

5.3 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.

5.4 This council also 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 Resources Committee before they were reported to the full council.

5.5 The council's investment policy is governed by Communities and Local Government (CLG) guidance, which was implemented in the annual investment strategy approved by the council on 18 March 2015. The Credit Worthiness policy was amended and approved by the council on 18 March 2015. 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).

5.5 It has come to light that in the first 6 months of 2015-16, there has been one breach of the Annual Investment Strategy, which was reported to committee on 21st October 2015. Following this a review has been undertaken and internal control and procedures have been reviewed in order to mitigate this risk and other control risk.

5.6 The Chief Financial Officer confirms that the remaining approved limits within the Annual Investment Strategy were not breached during the months of 2015-16.

5.7 Other than the issues discussed in 5.5, the Council has complied fully with the requirements of its approved Treasury Management Strategy during the period including use of approved counterparties and investment limits. The council had no liquidity difficulties.

5.8 Investments held by the Council: The Council maintained an average balance of £20m of internally managed funds, which is a combination of short and long term investments. These investments earned an average rate of return of 0.87% which compares with a budget assumption of £24.5m investment balances earning an average rate of 1.20%.

6 Discussion

Investments

6.1 At 31 March 2016 the Council held the following investments.

Money Market transactions:

Short term investments for periods of less than 1 year:

Investments	Range of Interest Rates Receivable %	Total Investment at 31 March 2015 £0	Total Investment at 31 March 2016 £0
Building Societies	0.5% -1.10%	21,059	18,098
Banks	0.65% - 0.75%	-	1,501
Other Local Authorities	-	-	-
Total		**21,059**	**19,599**

Long term investments for periods greater than 1 year

Long Term Investments	Period	Range of Interest Rates Receivable %	Total Investment at 31 March 2015 £0	Total Investment at 31 March 2016 £0
Building Societies	1–3 years			
Banks	1–5 years	0.25-0.40	3,546	506
Other Local Authorities		-	-	-
Total			**3,546**	**506**

Total investments for the year were therefore

	31 March 2015	31st March 2016
Short Term Investments	21,059	19,599
Long Term investments	3,546	507
Total investments	**24,605**	**20,106**
Bank Balance	2,958	2,212
Total cash available for Investment	**27,563**	**22,318**

The year on year variance for money market transactions is therefore a decrease of £5.245 m, which is due to the following:

- A result of spending on capital schemes throughout the year totalling £5.192m. £3.5m of which was for the Crematorium.

6.2 The average rate of interest earned on investments during the year was 0.87% (2014-15 0.83%).

6.3 **Investment Trusts:**

At the 31 March 2016 the Council held long term investments of share capital in the BlackRock Income Strategies Trust (previously known as British Assets Trust) investment with the following comparative values:

	31 March 2015 £000	**31 March 2016 £000**
Purchase Price	157	157
Market Value	328	303

6.4 The authority's statutory accounts are required to disclose the fair value of investments. The difference in the value of the BlackRock income Strategies Trust Investment when compared to the historical cost, amounted to a decrease in value of £26k (in 2014-15 there was a decrease of £12k), due to a fall in the share price to £1.21. The decrease in value (£26k) has been credited to the Available for Sale Financial Instruments Reserve.

Borrowing

6.5 The authority became debt free in December 2002; consequently the authority has no outstanding borrowings (other than those inherent in Finance Leases).

Interest Received

6.6 Details of interest received during 2015-16 compared with the estimate are as follows:

	2015-16 Original Estimate £	**2015-16 Actual £**	**Variance Original Est. to Actual £**
Amount received;			
Investment income	312,000	248,000	-64,000
Dividends	12,600	16,350	3,750
Other (incl. bank interest)	-	16,093	16,093
Total	**324,600**	**280,443**	**-44,157**

Future Prospects

6.7 Clearly, future prospects for generating investment income to support the annual revenue budget continue to be dependent on the level of balances and future movement in the level of interest rates. However, at the time of writing this report, whilst the outcome of the EU referendum is still unknown; the result may well have a significant impact on interest rates in the near future. This uncertainty highlights the continuing need for increased treasury management skills internally and external professional advice to assist in achieving future maximum investment returns.

6.8 Interest rates started to reduce dramatically towards the end of 2013-14 and this continued throughout 2014-15 and 2015-16. Recent investment activity has shown that banks and building societies are cash rich and therefore do not need as much investment as previously. This has had a knock on effect in that the interest rates that are being offered are being reduced further. In 2015-16 this lead to an additional budget pressure of approximately £64k.

7 Legal Powers

Local Government Act 2003.

8 Financial and Value For Money Implications

As shown in the report.

9 Risk Analysis

Nature of risk	Consequences if realised	Likelihood of occurrence	Control measures
Losses on invested funds	Potentially significant to the Council	Unlikely	Treasury management strategy
Fluctuations in interest rates	Beneficial if interest rates rise, adverse when interest rates fall	Investment income rates continue to be at historically low levels	Use of external advisors to determine best strategy

10 Implications for Resources

As shown in the report.

11 Implications for Stronger and Safer Communities

No direct implications.

12 Implications for Equalities

No direct implications.

13 Author and Contact Officer

H Essom, Treasury and Technical Officer

14 Consultees

L Elliott, Head of Finance.
S Knowles, Principal Finance Manager

15 Background Papers

The Prudential indicators and Treasury Management Report 2015-16 Resources committee 18 March 2015.
2015-16 Final Accounts working papers
Information received from Sector Treasury Services Ltd., the Council's Treasury Management advisers.

Appendix 1

Prudential Indicators for the year 2015-16

The Capital Prudential Indicators 2016/17 – 2018/19

The Council's capital expenditure plans are the key driver of treasury management activity. The outputs of the capital expenditure plans are reflected in prudential indicators, which are designed to assist member's overview and confirm capital expenditure plans.

Capital Expenditure. This prudential Indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle.

Capital Expenditure £m	2014/15 Actual	2015/16 Actual	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Total	**2.250**	**5.243**	**7.437**	**0.509**	**0.068**

Other long term liabilities. The above financing need excludes other long term liabilities, such as PFI and leasing arrangements which already include borrowing instruments. The Council has no finance leases which effectively include borrowing instruments:

The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding need (borrowing).

Capital Expenditure £m	2014/15 Actual	2015/16 Actual	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Total	**2.250**	**5.192**	**7.437**	**0.509**	**0.0.68**
Financed by:					
Capital generated in year receipts	**1.499**	**1.063**	**5.356**	**0.245**	**0.068**
Capital grants	**0.454**	**0.409**	**2.081**	**0.264**	**-**
Capital receipts reserves	**0.297**	**3.720**	**-**	**-**	**-**
Revenue					
Net financing need for the year	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**

The Council's Borrowing Need (the Capital Financing Requirement)

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each assets life.

The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst this increases the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has no such schemes within the CFR.

For several years the Council has had a significant negative CFR, indicating that capital expenditure has been over-financed in previous years. During 2015-16, this was verified by an exercise which demonstrated that there was a cash surplus within the Balance Sheet, corresponding to the negative CFR (a surplus of £8.550m compared to a negative CFR of £8.687m) and an appropriate transfer has been made to eliminate the duplicate funding. The residual negative CFR of £137k has been written off.

£m	2014/15 Actual	2015/16 Actual	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Capital Financing Requirement					
CFR – non housing	**-8.686**	**-**	**-**	**-**	**-**
CFR – housing	**-**	**-**	**-**	**-**	**-**
Total CFR	**-8.686**	**8.686**	**-**	**-**	**-**
Movement in CFR	**-0.003**	**-**	**-**	**-**	**-**

Movement in CFR represented by					
Net financing need for the year (above)	**-**	**-**	**-**	**-**	**-**
Less MRP/VRP and other financing movements	**-0.003**	**-**	**-**	**-**	**-**
Movement in CFR	**-0.003**	**-**	**-**	**-**	**-**

MRP Policy Statement

The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

CLG Regulations have been issued which require the full Council to approve **an MRP Statement** in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement:

The Council will make provision in its revenue accounts each year to meet the costs of the Principal element of Finance Leases.

The Use of the Council's Resources and the Investment Position

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year end balances for each resource and anticipated day to day cash flow balances.

Year End Resources	2014/15 Actual £m	2015/16 Actual £m	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m
Fund balances / reserves	7.9	7.8	7.2	6.6	5.7
Capital receipts	12.604	17.382	19.994	20.249	20.249
Provisions	0.065	0.065	0.065	0.065	0.065
Other					
Total core funds	**20.569**	**25.247**	**27.259**	**26.914**	**26.014**
Working capital*	-1.692	-2.929	-2.0	-2.0	-2.0
Under/over borrowing	8.686	-	-	-	-
Expected investments	**27.563**	**22.318**	**27.259**	**26.914**	**26.014**

*Working capital balances shown are estimated year end; these may be higher mid year

Affordability Prudential Indicators

The Prudential Code for Capital Expenditure in Local Authorities requires each Council to set and report against indicators showing:

- the cost of servicing long-term borrowing, including both interest costs and provision for loan repayment, as a percentage of total net service costs, and
- the impact on Council Tax levels of funding additional capital expenditure from borrowing.

The previous sections cover the capital prudential indicators, but the prudential indicators required to assess the affordability of the capital investment plans, are not reported because the Council is debt-free and is projected to remain so for the foreseeable future.

Current Portfolio Position

The Council's treasury portfolio position at 31 March 2016, with forward projections are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

£m	2014/15 Actual	2015/16 Actual	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
External Debt					
Debt at 1 April	-	-	-	-	-
Expected change in Debt	-	-	-	-	-
Other long-term liabilities (OLTL)	0.003	-	-	-	-
Expected change in OLTL	0.003	-	-	-	-
Actual debt 31 March	0.000	-	-	-	-
The Capital Financing Requirement					
Under/(over) borrowing	-8.686	-	-	-	-
Total investments at 31 March					
Investments	27,563	22,318	27,259	26,914	26,014
Investment change	-	5.245	-4,941	345	900
Net Debt	-	-	-	-	-

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well defined limits. One of these is that the Council needs to ensure that its total debt, net of any investments, does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2015/16 and the following two financial years (shown as net borrowing above). This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Head of Finance reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

Treasury Indicators: Limits to Borrowing Activity

The Operational Boundary. This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

Operational boundary £m	**2014/15 Actual**	**2015/16 Actual**	**2016/17 Estimate**	**2017/18 Estimate**
Debt	0.050	0.050	0.050	0.050
Other long term liabilities	0.148	0.000	0.000	0.000
Total	0.198	0.050	0.050	0.050

The Authorised Limit for external debt. A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

1. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.
2. The Council is asked to approve the following Authorised Limit:

Authorised limit £m	**2014/15 Actual**	**2015/16 Actual**	**2016/17 Estimate**	**2017/18 Estimate**
Debt	**5.050**	**5.050**	**5.050**	**5.050**
Other long term liabilities	**0.148**	**0.000**	**0.000**	**0.000**
Total	**5.198**	**5.050**	**5.050**	**5.050**

ECONOMIC OVERVIEW

UK data is beginning to show that the EU referendum and the uncertainty it entails is having an impact on the economy. Q1 GDP growth was a moderate 0.4% and the Purchasing Manager Indices are indicative of further slowing in Q2. Unemployment also edged a little higher. Not all of this, however, can be laid at the feet of Brexit concerns given the volatility in the financial markets amid growing worries about global growth at the start of the year. Nevertheless, as the vote becomes imminent so the uncertainty will likely become increasingly influential on sentiment, and the economy. A vote to "remain" would likely see an economic recovery over the remainder of the year; a vote for "Brexit" and the immediate outlook becomes cloudy.

Activity data suggests that Q1 GDP growth in the US also slowed to an annualised rate of 0.8%, but this should prove to be short lived rather than the start of a downturn. Employment and income growth are improving at healthy levels, while the average of the two ISMs points to GDP growth bouncing to around 2.0% annualised in Q2. Furthermore, there are also indications that domestic price pressures are picking up. The evidence adds up to the Fed being pushed into a position where the domestic pressures outweigh the external influences, thus requiring them to act, possibly in June. Looking further ahead, some analysts suggest that rate increases could come faster than the markets are expecting.

Q1 saw EZ GDP growth of 0.6% exceed that in the US and UK, after a disappointingly sluggish performance in the second half of 2015. The hard data proved better than the surveys, while the composite PMI eased in April and pointed to growth slipping back to around 0.3% q/q. The latest trade and retail sales figures offered further evidence of this, with the benefits from previous declines in the €uro and oil prices starting to fade.

The Asia/Pacific region has seen a number of countries offering stimulus to their economies, including China, Japan, India and Singapore, but that does not appear to be having a particularly positive impact. The Chinese economy has shown signs of some stabilisation, but whether this is sustainable remains to be seen. Elsewhere in the region, the Japanese economy seems to be moving further away from Prime Minister Abe's desired outcomes.

UK – Economic recovery has slowed so far this year, with GDP growth of just 0.4% in Q1 leaving the annual rate unchanged at 2.1%. The economy remains unbalanced as industrial production and construction proved negative contributors. Survey evidence is downbeat about Q2, with April manufacturing and construction PMIs both dipping, and the composite measure indicative of only 0.1% quarterly growth. Brexit concerns are causing firms to defer some decisions until the outcome is known, but investment intentions is one area that has, so far, been largely unaffected. Household spending growth has slowed a touch, with retail sales contracting by 1.3% m/m in March, but monthly figures have been volatile, and the annual rate has eased to 2.7%, having run at 4.5% last year. Adding to evidence of retail concerns, the CBI sales balance fell sharply in April, suggesting that Q2 has opened softly. The BoE's agents' reported increased consumer services sector turnover in March, but it has been higher. Elsewhere, the Gfk consumer confidence reading turned negative, but it is strong in relative terms. The housing market has seen activity weaken in April, after the imposition of Stamp Duty changes. Mortgage approvals were down in March, while April's Nationwide house price inflation index also fell.

Data showed that the trade deficit narrowed in February, but looks to have increased over Q1, with the deficit with the Eurozone hitting a record level. Declines in trade with China appeared to have bottomed out, and activity showing signs of improving, but generally survey export orders' indices have been pretty tepid. With regards the currency, Sterling has given up about 10% in value since last November, which should benefit exporters over time. A "remain" vote in the referendum will probably see Sterling recover, but the size of the deficit should cap any upside.

On the jobs front, data indicates that the economy has slowed so far this year, with the rate of job growth dipping and unemployment increasing for the first time in seven months. Headline wage growth has fallen, largely on the back of the volatile bonus component, but underlying wage growth remains weak, despite the tightness of the labour market. The introduction of the National Living Wage has seen firms pull back in other areas of remuneration.

Deflation is becoming less of a concern since February, with headline consumer price inflation picking up to 0.5% in March, but this was driven by erratic items, thus there is a risk that the impact will be reversed. Though energy prices were higher on the month, the increase was weaker than that seen a year ago, so fuel prices weighed on CPI. Fuel prices increased further in April but, again, the base effect of the rises in the second quarter of last year is likely to hold back inflation in Q2 this year. Four of the main six energy suppliers have cut gas prices, which will pull on April's CPI figure, and with utility firms buying two years in advance, retail energy prices will likely drag on inflation for a while. Both domestic and imported producer food price deflation have eased recently but that will likely see upside inflationary pressure later in the year, as will the impact of weaker Sterling on imported goods price inflation. However, any increase in inflation should be limited as the previous strengthening of the currency and falling oil prices have still not fully worked their way up the supply chain. Weaker wage growth will also have a slowing impact on inflation. Overall, inflationary pressures are modest, so reaching the 2% target looks to still be some way off.