BOROUGH COUNCIL OF WELLINGBOROUGH **AGENDA ITEM 6**

Resources Committee **28 June 2017**

Report of Section 151 Officer

Treasury Management Outturn – Annual Report 2016-17

1 Purpose of report

The purpose of this report is to present the annual report of treasury management activity for 2016-17. 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 2016-17.

3 Appendices

Appendix 1 Prudential Indicators for the year 2016-17
Appendix 2 Economic Overview as at 31st May 2017

The Committee is invited to RECOMMEND to:

4.1 APPROVE 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 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).

5.2 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 23 March 2016)
- a mid-year treasury update report (Council 2 November 2016)
- 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 23 March 2016. The Credit Worthiness policy was amended and approved by the council on 23 March 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).

5.6 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.

5.7 Investments held by the Council: The Council maintained an average balance of £24.3m 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 £25.6m investment balances earning an average rate of 0.60%.

6 Discussion

Investments

6.1 At 31 March 2017 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 2016 £'000	Total Investment at 31 March 2017 £'000
Building Societies	0.5% -1.10%	18,098	20,124
Banks	0.65% - 0.75%	1,501	-
Other Local Authorities	-	-	-
Total		**19,599**	**20,124**

Long term investments for periods greater than 1 year:

Long Term Investments	Period	Range of Interest Rates Receivable %	Total Investment at 31 March 2016 £'000	Total Investment at 31 March 2017 £'000
Building Societies	1–3 years			
Banks	1–5 years	0.25-0.40	507	-
Other Local Authorities		-	-	-
Total			**507**	**0**

Total investments for the year were therefore:

	31st March 2016 £'000	31st March 2017 £'000
Short Term Investments	19,599	20,124
Long Term investments	507	-
Total investments	**20,106**	**20,124**
Bank Balance	2,212	2,165
Total cash available for Investment	**22,318**	**22,289**

The year on year variance for money market transactions is therefore a slight decrease of £29k, which reflects the stabilising of the money market following a period of falling interest rates.

6.2 The average rate of interest earned on investments during the year was 0.87% (2015-16 0.87%).

Investment Trusts:

6.3 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 2016 £000	31 March 2017 £000
Purchase Price	157	157
Market Value	303	288

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 £15k (in 2015-16 there was a decrease of £26k), due to a fall in the share price to £1.205. The decrease in value (£15k) has been charged 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 2016-17 compared with the estimate are as follows:

	2016-17 Original Estimate £	2016-17 Actual £	Variance Original Est. to Actual £
Amount received;			
Investment income	225,000	206,343	-18,657
Dividends	12,000	12,263	263
Other (incl. bank interest)		22,754	22,754
Total	**237,000**	**241,360**	**4,360**

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 Brexit negotiations and the parliamentary election 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 2015-16 before stabilising in 2016-17. 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 remaining at a low level. In 2016-17 this lead to a small budget surplus of approximately £5k.

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

Tracey Cave, Service Accountant

14. Consultees

L Elliott, Managing Director
S Knowles, Principal Finance Manager
J O'Connell, Accountancy Team Leader

15. Background Papers

The Prudential Indicators and Treasury Management Report 2016-17 Resources committee 15 March 2017.
2016-17 Final Accounts working papers
Information received from Capita Assets Services Ltd., the Council's Treasury Management advisers.

Appendix 1

Prudential Indicators for the year 2016-17

The Capital Prudential Indicators 2017/18 – 2019/20

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	2015/16 Actual	2016/17 Actual	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Total	**5.192**	**2.051**	**6.635**	**0.068**	**0.034**

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	2015/16 Actual	2016/17 Actual	2017/18 Estimate	2017/18 Estimate	2019/20 Estimate
Total	**5.192**	**2.051**	**6.635**	**0.068**	**0.034**
Financed by:					
Capital generated in year receipts	**1.063**	**1.775**	**10.675**	**0.68**	**0.034**
Capital grants	**0.409**	**0.562**	**1.997**	**-**	**-**
Capital receipts reserves	**3.720**	**-0.286**	**-6.037**	**-**	**-**
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 was been made to eliminate the duplicate funding. The residual negative CFR of £137k was written off. No borrowing is anticipated in the foreseeable future.

£m	2015/16 Actual	2016/17 Actual	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Capital Financing Requirement					
CFR non housing	-	-	-	-	-
CFR housing	-	-	-	-	-
Total CFR	8.687	-	-	-	-
Movement in CFR	-	-	-	-	-

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

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	2015/16 Actual £m	2016/17 Actual £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m
Fund balances / reserves	7.8	7.2	6.1	5.5	4.6
Capital receipts	17.382	17.634	23.164	23.346	23.562
Provisions	0.065	0.065	0.065	0.065	0.065
Other					
Total core funds	**25.247**	**24.899**	**29.329**	**28.911**	**28.227**
Working capital*	-2.929	-2.610	-2.000	-2.000	-2.000
Under/over borrowing	-	-	-	-	-
Expected investments	**22.318**	**22.289**	**27.329**	**26.911**	**26.227**

*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 2017, 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	2015/16 Actual	2016/17 Actual	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
External Debt					
Debt at 1 April	-	-	-	-	-
Expected change in Debt	-	-	-	-	-
Other long-term liabilities (OLTL)	-	-	-	-	-
Expected change in OLTL	-	-	-	-	-
Actual debt 31 March	-	-	-	-	-
The Capital Financing Requirement					
Under/(over) borrowing	-	-	-	-	-
Total investments at 31 March					
Investments	22,318	22,289	27,329	26,911	26,227
Investment change	5,245	-29	5,040	-418	-684
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	2015/16 Actual	2016/17 Actual	2017/18 Estimate	2018/19 Estimate
Debt	0.050	0.050	0.050	0.050
Other long term liabilities	0.000	0.000	0.000	0.000
Total	0.050	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	2015/16 Actual	2016/17 Actual	2017/18 Estimate	2018/19 Estimate
Debt	**5.050**	**5.050**	**5.050**	**5.050**
Other long term liabilities	**0.000**	**0.000**	**0.000**	**0.000**
Total	**5.050**	**5.050**	**5.050**	**5.050**

ECONOMIC OVERVIEW as at 31st May 2017

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. By the end of March 2017, sterling was 17% down against the dollar but had not fallen as far against the euro. In February 2017, the latest CPI inflation figure had risen to 2.3%, above the MPC's inflation target of 2%. However, the MPC's view was that it would look through near term supply side driven inflation, (i.e. not raise Bank Rate), caused by sterling's devaluation, despite forecasting that inflation would reach nearly 3% during 2017 and 2018. This outlook, however, is dependent on domestically generated inflation, (i.e. wage inflation), continuing to remain subdued despite the fact that unemployment is at historically very low levels and is on a downward trend. Market expectations for the first increase in Bank Rate moved forward to quarter 3 2018 by the end of March 2017 in response to increasing concerns around inflation.

USA. Quarterly growth in the US has been very volatile during 2016 but a strong performance since mid-2016, and strongly rising inflation, prompted the Fed into raising rates in December 2016 and March 2017. The US is the first major western country to start on a progressive upswing in rates. Overall growth in 2016 was 1.6%.

EU. The EU is furthest away from an upswing in rates; the European Central Bank (ECB) has cut rates into negative territory, provided huge tranches of cheap financing and been doing major quantitative easing purchases of debt during 2016-17 in order to boost growth from consistently weak levels, and to get inflation up from near zero towards its target of 2%. These purchases have resulted in depressed bond yields in the EU, but, towards the end of 2016, yields rose, probably due at least in part to rising political concerns around the positive prospects for populist parties and impending general elections in 2017 in the Netherlands, France and Germany. The action taken by the ECB has resulted in economic growth improving significantly in the eurozone to an overall figure of 1.7% for 2016, with Germany achieving a rate of 1.9% as the fastest growing G7 country.

On the other hand, President Trump's election and promise of fiscal stimulus, which are likely to increase growth and inflationary pressures in the US, have resulted in Treasury yields rising sharply since his election. Gilt yields in the UK have been caught between these two influences and the result is that the gap in yield between US treasuries and UK gilts has widened sharply during 2016/17 due to market perceptions that the UK is still likely to be two years behind the US in starting on an upswing in rates despite a track record of four years of strong growth.

Japan struggled to stimulate consistent significant growth with GDP averaging only 1.0% in 2016 with current indications pointing to a similar figure for 2017. It is also struggling to get inflation up to its target of 2%, only achieving an average of -0.1% in 2016, despite huge monetary and fiscal stimulus, though this is currently expected to increase to around 1% in 2017. It is also making little progress on fundamental reform of the economy.

China and emerging market counties. At the start of 2016, there were considerable fears that China's economic growth could be heading towards a hard landing, which could then destabilise some emerging market countries particularly exposed to a Chinese economic slowdown and / or to the effects of a major reduction in revenue from low oil prices. These fears have largely subsided and oil prices have partially recovered so, overall, world growth prospects have improved during the year.

Equity markets. The result of the referendum, and the consequent devaluation of sterling, boosted the shares of many FTSE 100 companies which had major earnings which were not denominated in sterling. The overall trend since then has been steeply upwards and received further momentum after Donald Trump was elected President as he had promised a major fiscal stimulus to boost the US economy and growth rate.