Part I
Release to Press

Meeting:	**AUDIT COMMITTEE / EXECUTIVE / COUNCIL**	**Agenda Item:**	**9**
Portfolio Area:	Resources		
Date:	**6 SEPTEMBER / 19 SEPTEMBER / 11 OCTOBER**		

Financial security

ANNUAL TREASURY MANAGEMENT REVIEW OF 2016/17 INCLUDING PRUDENTIAL CODE

NON-KEY DECISION

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1. PURPOSE

1.1 To review the operation of the 2016/17 Treasury Management and Investment Strategy.

2. RECOMMENDATIONS

2.1 **Audit Committee & Executive**
That subject to any comments the 206/17 Annual Treasury Management Review be recommended to Council for approval.

2.2 **Council**
That, subject to any comments from the Audit Committee and the Executive, the 2016/17 Annual Treasury Management Review be approved.

3. BACKGROUND

3.1 **Regulatory requirement**

3.1.1 The Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management reviewing 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).

3.1.2 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 24/02/2016)
- a mid-year treasury update report (Council 7/12/2016)
- an annual review following the end of the year describing the activity compared to the strategy (this report).

3.1.3 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.

3.1.4 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 Audit Committee and the Executive before they were reported to the Council.

3.2 **Economy and Interest rates in 2016/17**

3.2.1 The two major landmark events that commentators have reported as having 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 3rd quarter of 2018 to 4th quarter of 2019. At its 4 August 2016 meeting (the first meeting after the referendum result), 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, the Bank restarted quantitative easing with purchases of £60bn of gilts and £10bn of corporate bonds, and introduced the Term Funding Scheme whereby potentially £100bn of cheap financing was made available to banks.

3.2.2 In the second half of 2016, the Bank's pessimistic forecasts for the UK economy were not realised. After a disappointing 1st quarter 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%. This meant that the MPC did not cut Bank Rate again after August but, since then, inflation has risen due to the effects of the sharp devaluation of sterling after the referendum but fell away slightly in July 2017. (July 2017 CPI - 2.6%).

4. OVERALL TREASURY POSITION AS AT 31 MARCH 2017

4.1 At the beginning and the end of 2016/17 the Council's treasury position was as follows:

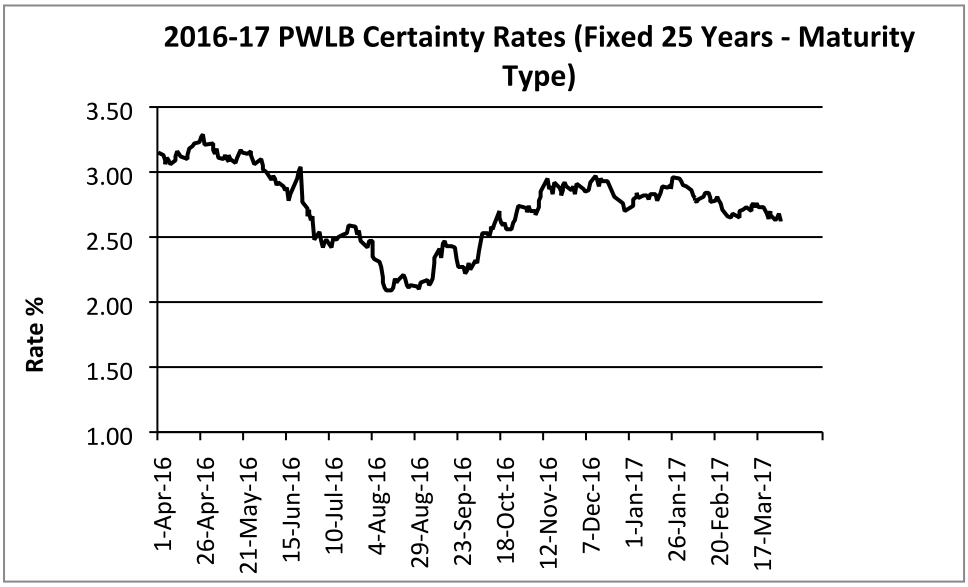
Table One: Treasury Position						
	2015/16			2016/17		
	31 March 2016 Principal £'000s	Rate / Return %	Average Life (Yrs)	31 March 2017 Principal £'000s	Rate / Return %	Average Life (Yrs)
Total Borrowing	**209,757**	**3.37**	**17.64**	**209,494**	**3.38**	**16.66**
Capital Financing Requirement	223,929			223,275		
Over/(under) borrowing	(14,172)			(13,781)		
Investments Portfolio	**51,060**	**0.61**		**57,595**	**0.57**	

5. TREASURY MANAGEMENT STRATEGY 2016/17

5.1 The original 2016/17 Treasury Management strategy had projected low but rising Bank Rate starting from 1st quarter of 2017 and gradual rises in medium and longer term fixed borrowing rates during 2016/17.

5.2 Continued uncertainty following the 2008 financial crisis promoted a cautious approach, whereby the Council's investments have been high grade, low risk having due regard to the "security, liquidity, yield" with security being the most important reflected in instant access and short (duration) call accounts being used. However, in the Treasury Management Review presented to Council on 28 February 2017 consideration has been given to slightly more diverse investments (see also para 5.9).

5.3 During 2016/17 there was major volatility in PWLB rates with rates falling during the 1st and 2nd quarters of 2016 to reach historically very low levels in July and August, before rising significantly during the 3rd quarter, and then partially easing back towards the end of the year.



5.4 The Council's Capital Expenditure and Financing 2016/17.

5.4.1 In 2016/17 the Council spent £24,231,000 on capital projects (General Fund and Housing Revenue Account). The total capital programme was funded from existing capital resources and no prudential borrowing was required. In addition no external loans were taken out during 2016/17 to fund existing borrowing requirements from previous years. Table two details capital expenditure and financing used in 2016/17.

Table Two: 2016/17 Capital Expenditure and Financing				
	2016/17 Original Estimate £'000	2016/17 Quarter 3 Revised Working Budget £'000	2016/17 Actual £'000	2016/17 Variance Actual to Quarter 3 Revised Working Budget £'000
Capital Expenditure:				
General Fund Capital Expenditure	7,101	6,958	4,829	(2,129)
HRA Capital Expenditure	25,316	21,842	19,402	(2,440)
Total Capital Expenditure	**32,417**	**28,800**	**24,231**	**(4,569)**
Resources Available for Capital Expenditure:				
Capital Receipts	(8,720)	(5,519)	(2,782)	2,737
Capital Grants /Contributions	(1,671)	(2,598)	(2,093)	505
Capital Reserves	(1,923)	(3,555)	(2,915)	640
Revenue contributions	(4,966)	(5,123)	(5,069)	54
Major Repairs Reserve	(15,137)	(12,005)	(11,372)	633
Total Resources Available	**(32,417)**	**(28,800)**	**(24,231)**	**4,569**
Capital Expenditure Requiring Borrowing	**0**	**0**	**0**	**0**

5.4.2 Since the original 2016/17 Treasury Management Strategy, Members have approved prudential borrowing for the garages asset management plan and the commercial property portfolio to support the Financial Security work stream. A proportion of the approved borrowing for these projects is expected to be taken out in 2017/18.

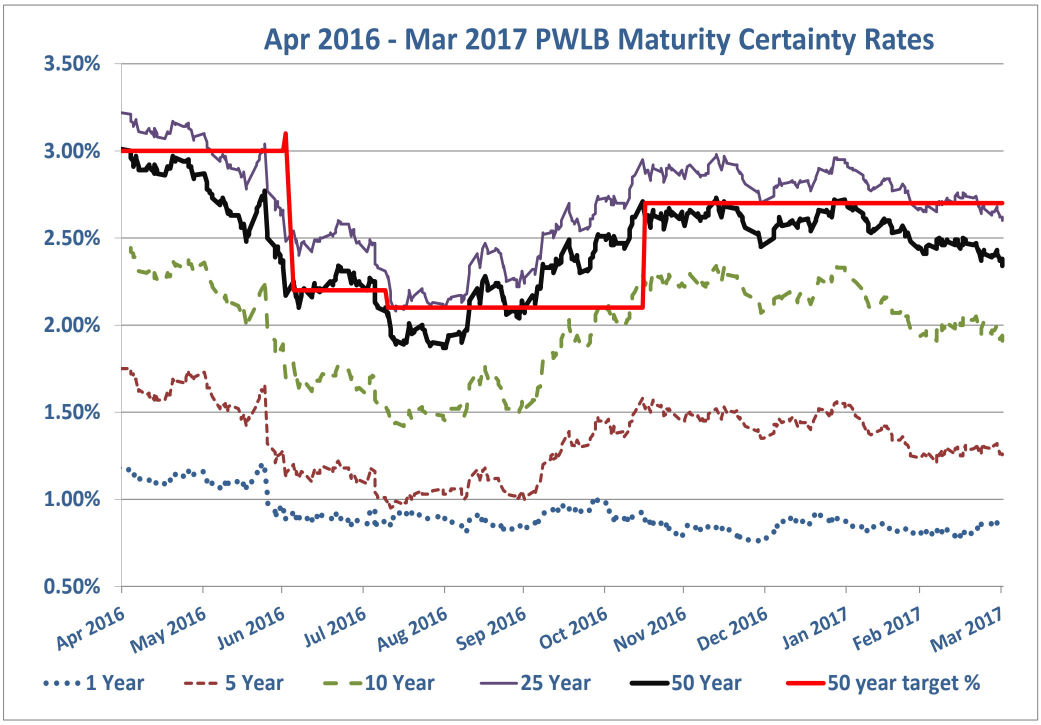
5.4.3 The Treasury Management review of 2016/17 Prudential Indicators have been updated to reflect changes to capital budgets which have been approved throughout the year. The actual capital expenditure for 2016/17 has already been reported to Executive on 17 July 2017.

5.5 **The Council's overall need to borrow and Capital Financing Requirement**

5.5.1 The Council's underlying need to borrow to fund it's capital expenditure is termed the Capital Financing Requirement (CFR). It represents the amount of debt it needs to/has taken out to fund the programme (and includes both internal and external borrowing). The CFR is then reduced as debt repayments are made and Minimum Revenue Provisions (MRP – see also para 5.6) are made. A separate CFR is calculated for the General Fund and Housing Revenue Account and any transfers of assets (such as land or buildings) will impact on each fund's CFR. The CFR will go up on the fund "receiving" the assets and go down (by the same amount) on the fund "giving" the asset.

5.5.2 While cash balances are relatively high the Council continues to use internal borrowing in line with its Capital Strategy and Treasury Management Strategy. This position is kept under review taking into account future cash balances and forecast borrowing rates. Members should note that these cash balances relate in part to restricted use right to buy "one for one" receipts (£10.9million) and provisions (£8.6million) for future liabilities.

5.5.3 **PWLB certainty maturity borrowing rates** - the graph below shows how PWLB certainty rates have fallen to historically very low levels during the year.



5.5.4 As at the 31 March 2017 the Council had total external borrowing of £209,493,947. The debt repayment profile is shown in the following table:

Table Three: Maturity of Debt Portfolio for 2015/16 and 2016/17		
Time to maturity	**31 March 2016 Actual £'000's**	**31 March 2017 Actual £'000's**
Maturing within one year	263	4,004
1 year or more and less than 2 years	4,004	1,763
2 years or more and less than 5 years	2,289	789
5 years or more and less than 10 years	1,026	8,763
10 years or more	202,175	194,175
Total	**209,757**	**209,494**

5.5.5 The General Fund had £3,078,947 external borrowing, £1,500,000 was with another local authority and the remainder with the Public Works Loan Board (PWLB). The HRA had external borrowing of £206,415,000 all held with the PWLB, of which £11,504,000 relates to pre 2012 decent homes programme and the remainder £194,910,000 to self financing payment made to central government in 2012.

5.5.6 The HRA borrowing is constrained by legislation and is capped at £217,685,000. As at the 31 March 2017 the head room available for new HRA borrowing is £9,179,078.

5.5.7 The Council's CFR is one of the key prudential indicators and is shown in the table below.

Table Four: Capital Financing Requirement 2015/16 and 2016/17			
CFR Calculation	**31-Mar-16 (£'000)**	**31-Mar-17 (£'000)**	**Movement in Year (£'000)**
Opening Balance	**230,082**	**223,929**	
Closing Capital Financing Requirement (General Fund)	15,423	14,769	(654)
Closing Capital Financing Requirement (Housing Revenue Account)	208,506	208,506	0
Closing Balance	**223,929**	**223,275**	
Increase/ (Decrease)	**(6,153)**	**(654)**	**(654)**

5.5.8 The CFR for the HRA remained unchanged as no debt repayments were made in year, no borrowing was required and no assets were transferred between the General Fund and HRA. In 2017/18 there is a scheduled debt repayment of £3,741,000, however further borrowing of £3,500,000 to be taken in 2017/18 has been approved as part of the updated HRA business plan.

5.5.9 The General Fund's CFR reduced by £653,628 - the Minimum Revenue Provision (MRP) made in year.

5.6 **Minimum Revenue Provision (MRP)**

5.6.1 The Prudential Code, by which the Council has to make its borrowing decisions, requires the Council to demonstrate that borrowing is required and affordable. The MRP is a statutory requirement to ensure borrowing is affordable for the General Fund and does not apply to the HRA (the HRA affordability has been determined by central government in setting the HRA's debt cap (see also para 5.5.6)). The Council is required to make an annual MRP based on its policy approved by Council as part of the Treasury Management Strategy. The calculation of MRP is based upon prior years' borrowing requirement (regardless of whether that borrowing was internal or external) and the life of the asset for which the borrowing was required.

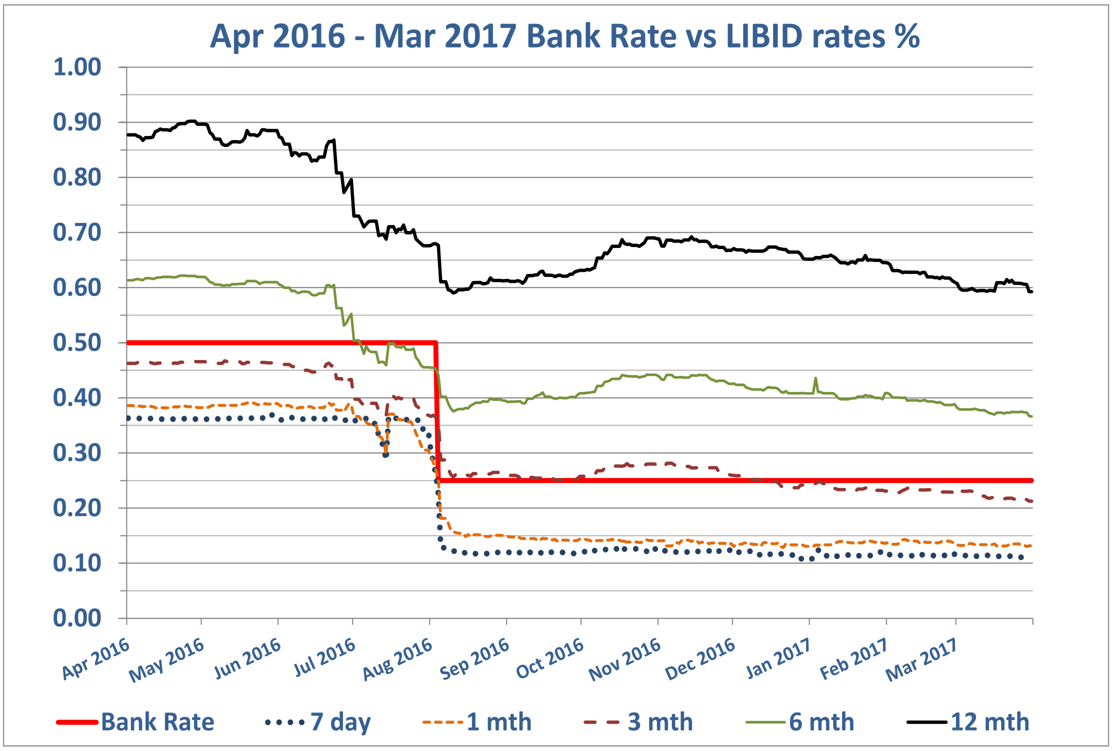
5.6.2 The MRP charged to the General Fund in 2016/17 was £653,628

5.7 **Cash Balances and Investment rates**

5.7.1 As at 31 March 2017 cash balances held by the Council were £57.595Million. During the year the average cash balance was £62Million, earning interest of £356,442 and achieving an average interest rate of 0.57%. The comparable rate was 0.20% (average 7-day LIBID rate). This compares with an original budget assumption of £375,770 based on average investment rate of 1.03% however higher cash balances offset the lower rate achieved.

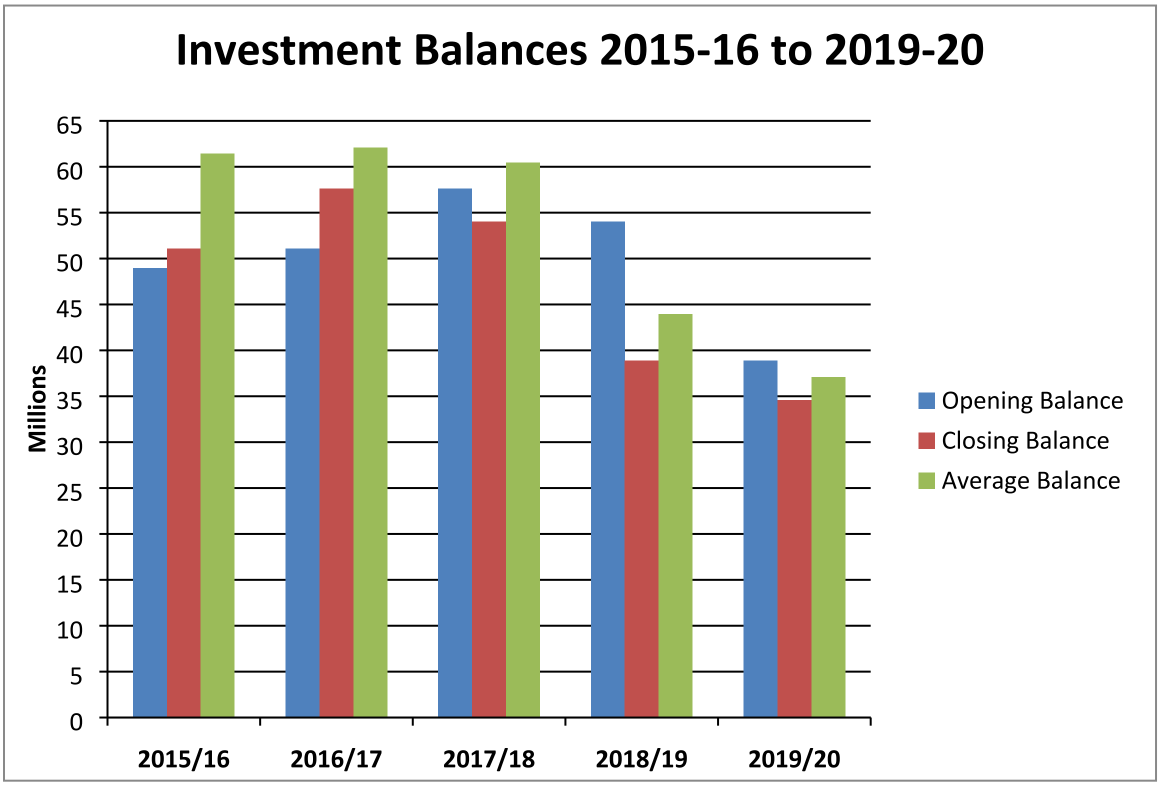
5.7.2 Members approved an increase in counter party limits . This was in part to avoid the use of Debt Management Office (DMO) as the investment of "last resort" as the interest rate is so low (currently 0.1%). No funds were placed with the DMO during 2016/17.

5.7.3 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 3rd quarter of 2018, but then moved back to around the end of 2019 in early August before finishing the year back at 3rd quarter of 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. The following chart shows Bank rate and LIBID rates in 2016/17.



5.7.4 Cash balances were £57million at the end of the year partly due to retention of one for one right to buy receipts ring fenced for HRA new social housing schemes (£10.9Million), provisions and reserves held for specific purposes and HRA balances (£19.7Million) the latter is forecast to be used in the next five years as mentioned in paragraph 5.5.2.

5.7.5 The following chart shows the historic level of cash balances and the current projections to 2019/20.



5.7.6 The Council invests it surplus cash balances in accordance with the Treasury Management Strategy approved by Council on 24 February 2016. The policy set 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 and counterparty limits dependant on level of cash balances held.

5.7.7 There were no breaches to this policy in 2016/17 with the investment activity during the year conforming to the approved strategy and the Council had no liquidity difficulties.

5.8 Other Prudential Indicators

5.8.1 The treasury management indicators for 2017/18 onwards have been updated based on the updated Capital Strategy approved by Council in February 2017 and subsequently updated in the 3rd and 4th quarter capital updates reported to Executive in March and July 2017.

5.8.2 The net borrowing position for the Council as at 31 March 2017 was £151.899Million (total borrowings/loans of £209.494Million less total investments held of £57.595Million).

5.8.3 The operational boundary and authorised limit refers to the borrowing limits within which the treasury team operate. A temporary breach of the operational boundary is permissible for short term cash flow purposes however a breach of the authorised limit would require a report to Council. There were no breaches of either limit in 2016/17.

5.8.4 The ratio of financing costs to net revenue stream is equal to General Fund interest costs divided by the General Fund net revenue income from Council tax, Revenue Support Grant and retained business rates. The 2016/17 indicator is 8.53%.

5.8.5 The full list of treasury prudential indicators is shown in Appendix A and has been updated for the 2016/17 outturn position and the revised 2017/18 capital programme.

5.9 **Treasury Position Post 31 March 2017**

5.9.1 The 2017/18 Treasury Management Strategy incorporated a number of updates to the investment strategy and the parameters in which officers work to invest the Council's cash balances.

5.9.2 Included in the 2017/18 Treasury Management strategy was an increase in the treasury limit for "fixed rate more than 12 months to maturity" when balances are in excess of £30million (Recommendation 2.3 Treasury Management Review including Prudential Code – Council 28 Feb 2017). Since implimentation £9.3Million is held in deposits of 12 month plus duration (currently balances are £70million and year end balances are forecast to be £67Million).

5.9.3 The total limit on the amount invested in Money Market Funds was revised (Recommendation 2.5 Treasury Management Review including Prudential Code – Council 28 Feb 2017) and since then a third Money Market fund has been added to the portfolio – Amundi. The maximum amount held to date in money market funds under the 2017/18 strategy was £23.8Million.

5.9.4 The use of enhanced cash funds was also approved in February. These funds are now referred to as "Ultra Short Dated Bond" (USDB) funds (Recommendation 2.7 Treasury Management Review including Prudential Code – Council 28 Feb 2017. Officers are liaising with the Council's treasury management advisors to find a suitable USDB funds that meet the Council's investment timescales and risk criteria. Currently no investments have been made with USDB funds.

6. IMPLICATIONS

6.1 Financial Implications

6.1.1 This report is of a financial nature and reviews the treasury management function for 2016/17. Any consequential financial impacts identified in the July Capital strategy and 4th quarter revenue budget monitoring report have been incorporated into this report.

6.1.2 During the financial year Officers operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices.

6.2 Legal Implications

6.2.1 Approval of the Prudential Code Indicators and the Treasury Management Strategy are intended to ensure that the Council complies with relevant legislation and best practice.

6.3 Equalities and Diversity Implications

6.3.1 This purpose of this report is to review the implementation of the Treasury management policy in 2016/17. Before investments are placed with counter parties the Council has the discretion not to invest with counter parties where there are concerns over sovereign nations' human rights issues.

6.3.2 The Treasury Management Policy does not have the potential to discriminate against people on grounds of age; disability; gender; ethnicity; sexual orientation; religion/belief; or by way of financial exclusion. As such a detailed Equality Impact Assessment has not been undertaken.

6.4 Risk Implications

6.4.1 The current policy of not borrowing externally only remains financially viable while cash balances are high and the differentials between investment income and borrowing rates remain. Should these conditions change the Council may need to borrow at higher rates which would increase revenue costs.

6.5 Policy Implications

6.5.1 This report confirms treasury decisions have been made in accordance with the policy.

BACKGROUND PAPERS

- BD1 Mid year Treasury update (Council 7 December 2016) http://www.stevenage.gov.uk/content/committees/160923/160927/160991/20160712-Item11.pdf
- BD2 Treasury Management Review including Prudential Code Indicators 2017/18 (Council 28 February 2017) http://www.stevenage.gov.uk/content/committees/160923/160927/160991/20170228-Item12.pdf

APPENDICES

- Appendix A Prudential Indicators
- Appendix B Investment and Borrowing Portfolio.