TRAFFORD BOROUGH COUNCIL

Report to:	**Executive 26 June 2017** **Accounts & Audit Committee 28 June 2017** **Council Meeting 26 July 2017**
Report for:	**Information**
Report of:	**The Executive Member for Corporate Resources and the Chief Finance Officer**

Treasury Management Annual Performance 2016/17 Report

Summary

This report outlines the treasury management activities undertaken during 2016/17, key issues are as follows:

- There has been full compliance with all legislative and regulatory requirements, including all treasury management prudential indicators;
- The average level of external debt and interest rate payable for 2016/17 was £105.2m and 5.67% compared to 2015/16 when the respective figures were £95.3m & 6.02%;
- The average level of all investments for 2016/17 was £105.6m with a rate of return of 0.87%, for 2015/16 this was £106.6m and 0.84% respectively;
- Budget savings of £(0.1)m in net interest payable (loan interest less investment interest) were achieved.

Recommendations

That the Accounts & Audit Committee and Executive advise the Council:

1. of the Treasury Management activities undertaken in 2016/17;
2. that no prudential limits were breached during 2016/17;
3. that there was full compliance with both the CIPFA Code of Practice on Treasury Management and CIPFA Prudential Code for Capital Finance.

Contact person for background papers:
Graham Perkins – Technical Accountant - Extension: 4017

Background papers: None

Relationship to Policy Framework/Corporate Priorities	Value for Money
Financial	In 2016/17 the Council paid loan interest of £6.0m and received investment interest of £(0.9)m from money market investments and the net effect of this was a net saving of £(0.1)m against budget.
Legal Implications:	All actions undertaken during the year were in accordance with legislation, CLG Guidance, CIPFA Prudential Code and CIPFA Treasury Management Code of Practice.
Equality/Diversity Implications	Not applicable
Sustainability Implications	Not applicable
Staffing/E-Government/Asset Management Implications	Not applicable
Risk Management Implications	The monitoring and control of risk underpins all treasury management activities. The Council's in-house treasury management team continually monitor to ensure that the main risks associated with this function of adverse or unforeseen fluctuations in interest rates are avoided and security of capital sums are maintained at all times.
Health and Safety Implications	Not applicable

1. INTRODUCTION AND BACKGROUND

1.1 In accordance with regulations issued under the Local Government Act 2003 local authorities are required by regulation to have regard to both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance (the Prudential Code) when undertaking this function. This report which reviews the activities and actual prudential and treasury indicators for 2016/17 meets the requirements of these Codes.

1.2 During 2016/17, the Accounts & Audit Committee together with the Executive and Full Council received the following three reports:

- annual treasury strategy for the year ahead (issued February 2016);
- mid-year update report (issued November 2016);
- annual outturn report describing the activity undertaken (June 2017 i.e. this report).

1.3 The current regulatory environment places responsibility on Members to review and scrutinise the treasury management policies and activities of the Council. 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. Training was provided to Members during the year to support their understanding of this topic.

1.4 The figures in this report are based on the actual amounts borrowed and invested and as such will differ from those stated in the final accounts which are shown in compliance with International Financial Reporting Standards.

1.5 The report comprises of the following sections:

- Major Economic Headlines 2016/17 (Section 2);
- Treasury Position (Section 3);
- Borrowing Position (Section 4);
- Investment Position (Section 5);
- Related Treasury Issues (Section 6);
- Prudential and Performance indicators (Section 7);
- Appendices.

2. MAJOR ECONOMIC HEADLINES 2016/17

2.1 A brief summary of the main events which occurred during the year are highlighted below for reference;

USA

- Election of President Trump on 9 November 2016;
- Overall growth in 2016 was 1.6%;
- Volatile quarterly growth during 2016 together with strongly rising inflation, prompted the Federal Reserve into raising rates in December 2016 and March 2017;
- First major western country to start on a progressive upswing in rates.

EU

- Still remains to be some distance away from any upswing in rates;
- European Central Bank (ECB) cut rates into negative territory, provided huge tranches of cheap financing and carried out major quantitative easing purchases of debt in order to boost growth from consistently weak levels, and to get inflation up from near zero towards its target of 2%;
- The action taken by the ECB resulted in an improvement in economic growth to an overall figure of 1.7%, with Germany achieving a rate of 1.9% as the fastest growing G7 country;

- Rising political concerns around the positive prospects for populist parties and impending general elections in 2017 in the Netherlands, France and Germany, give some cause for concern.

Japan

- Continues to struggle to generate consistent significant growth with GDP averaging only 1.0%;
- Inflation remains below target of 2%, only achieving an average of -0.1% in 2016, despite huge monetary and fiscal stimulus;
- It is also making little progress on fundamental reform of the economy.

China

- Fears that China's economic growth would head towards a hard landing, thereby destabilising countries exposed to its economy subsided.

UK

- As a consequence of the outcome of the Brexit referendum in June 2016 the money markets revised its expectations of when the first increase in Bank Rate would happen, to quarter 4 2019 from quarter 3 2018;
- In August the Monetary Policy Committee (MPC), cut the Bank Rate from 0.5% to 0.25%, the first move since March 2009 and warned that it would consider cutting it again in order to support growth.
- Additional Quantitative Easing with gilt and corporate bond purchases of £60bn and £10bn respectively being undertaken by the Bank of England together with the introduction of a £100bnTerm Funding Scheme providing cheap financing to banks.
- The economy grew by 1.8% when compared to 2015 and remains one of the strongest of any G7 country;
- By the end of March 2017, sterling was 17% down against the dollar but had not fallen as far against the euro;
- CPI started the year in April at 0.7% rising to 2.3% in February 2017, 0.3% above the MPC's inflation target of 2% and this was driven primarily by inflation, caused by sterling's devaluation.
- Unemployment rate continued to fall from the April 2016 opening position of 5.1% to 4.8% in March 2017 with the position for Trafford moving from 3.7% in April 2016 to 3.6% in March 2017;

2.2 Within the treasury management strategy for 2016/17 the expectation was for interest rates to remain low with Bank Rate starting to rise in quarter 1 of 2017 with gradual rises in medium and longer term fixed borrowing rates. As a result of the economic situation highlighted at paragraph 2.1 this had the opposite effect to that originally anticipated with rates easing during the year as highlighted in the table below; and a more detailed analysis detailing how investment rates moved during the course of the year is provided at Appendix A;

	2016/17	**1 April 2016**	**31 March 2017**	**2016/17**
	Forecast Average	**Actual**	**Actual**	**Actual Average**
	%	**%**	**%**	**%**
UK Bank Rate	0.63	0.50	0.25	0.34
Investment Rates				
3 month	0.70	0.46	0.21	0.32
1 Year	1.15	0.88	0.59	0.70
Loan Rates				
5 Year	2.25	1.61	1.24	1.56
25 Year	3.55	3.13	2.60	2.92

3. TREASURY POSITION

3.1 The Council's in-house Treasury Management team controls the debt and investment positions to ensure that security of funds, adequate liquidity for revenue and capital activities are maintained at all times and risks connected with these activities are managed effectively.

3.2 Procedures and controls to achieve these objectives are well established both through Member reporting and officer activity and this was further highlighted when the Council's Audit & Assurance Service issued a report which for the 10th year in succession, stated that the treasury management service offered a High Level of Assurance.

3.3 The table below shows the loan and investment positons at the beginning and end of 2016/17 for reference:

	31 March 2017			31 March 2016		
	Principal (£m)	**Total (£m)**	**Interest Rate %**	**Principal (£m)**	**Total (£m)**	**Interest Rate %**
DEBT						
Fixed rate:						
-PWLB	43.4			47.2		
-Market	10.8	54.2	5.18	6.0	53.2	5.84
Variable rate:						
-PWLB	0.0			0.0		
-Market	51.0	51.0	5.77	51.0	51.0	5.73
Total debt		**105.2**	**5.47**		**104.2**	**5.79**
Capital Financing Requirement (to finance past capital expenditure)		**144.0**			**134.8**	
Over/ (under) borrowing		**(38.8)**			**(30.6)**	
INVESTMENTS						
- Fixed rate	58.4		0.62	39.3		0.97
- Variable rate	24.0		1.13	42.5		1.00
Total investments		**82.4**	**0.77**		**81.8**	**0.98**

Note - The above interest rates reflect the actual position as at 31 March.

3.4 Whilst the above table details the position as at the beginning and end of 2016/17, the average position for 2016/17 & 2015/16 was as follows:

	2016/17		2015/16	
	Principal	**Interest Rate**	**Principal**	**Interest Rate**
Average Debt	£105.2m	5.67%	£95.3m	6.02%
Average Investment	£105.6m	0.87%	£106.6m	0.84%

4. BORROWING POSITION

4.1 The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR) and is a gauge of the Council's indebtedness. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represents the 2016/17 and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

4.2 The Council's CFR is not allowed to rise indefinitely and statutory controls are in place to ensure that any borrowing on capital assets is charged to revenue over their useful life. This charge is in the form of an annual revenue charge, called the Minimum Revenue Provision (MRP), which reduces the CFR and effectively is a repayment of borrowing need.

4.3 The Council's 2016/17 MRP Policy, (as required by CLG Guidance), was approved by Members as part of the Treasury Management Strategy Report for 2016/17 on 17 February 2016.

4.4 In response to the continuing interest rate differential between the cost of long term debt (2.6% PWLB 25yrs) compared to the levels of return available from investments (under 0.59%), the Council continued with its the strategy adopted since the 2008 financial crisis, of borrowing internally (using cash backed reserves) to fund its long term borrowing requirement and maturing debt. This course of action continues to be widely followed by Councils nationally and was undertaken in conjunction with advice obtained from the Council's external advisers Capita.

4.5 As a consequence of this action, the Council is in an under-borrowed position by £38.8m as highlighted at paragraph 3.3 and had this level of debt been taken for 25 years at 31 March 2017, the Council would be incurring an additional £780k per year in net interest payable (£1,009k loan interest less £(229)k investment interest).

4.6 Interest payable for the year totalled £6.0m and this exceeded budget by £0.1m due to higher than forecasted interest costs arising from the Council's variable rate loan.

4.7 From the table at paragraph 3.3 it can be seen that the level of external debt increased during 2016/17 from the opening position of £104.2m to close at £105.2m as a result of the following transactions;

Lender	Principal – (Repayment) / New	Average Interest rate	Reason
PWLB	£(3,749,486)	7.997%	Natural maturity
SALIX Finance	£4,760,731	0%	Additional tranches of the £6.3m loan agreement to be used on the Council's Street Lighting Replacement Programme

4.8 Of the debt outstanding of £105.2m, £0.9m is administered on behalf of Greater Manchester Probation Service which leaves £104.3m in respect of the Council's own long term requirement.

4.9 A maturity profile of the Council's debt can be found at Appendix B & C for reference.

4.10 No rescheduling of the Council's existing debt was undertaken during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made this unviable due to the high breakage costs (premium) payable.

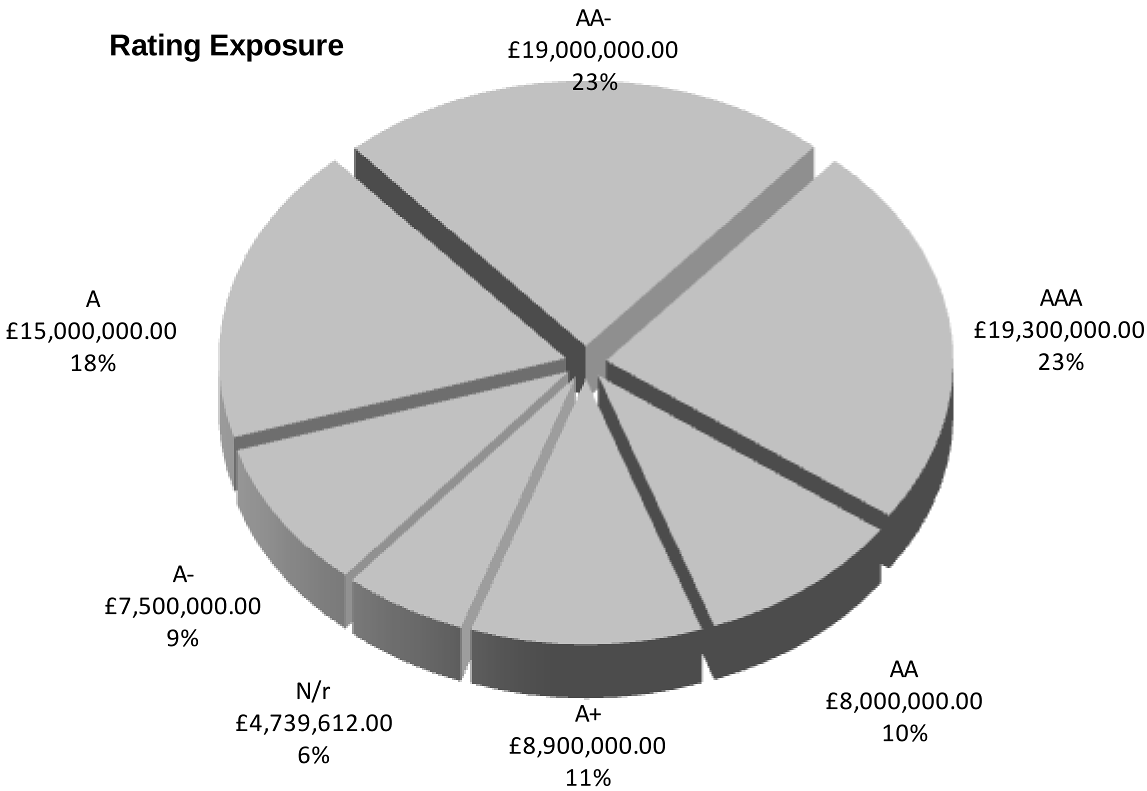
5. INVESTMENT POSITION

5.1 The Council's investment policy is governed by DCLG guidance issued in March 2010 and this has been implemented within the annual investment strategy approved by Council on 17 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.).

5.2 Using this information the Council's in-house treasury management team produces an approved lending list in order to ensure investments are only placed with low risk institutions with funds being invested for a range of periods from overnight to 3 years dependant on cash flow requirements, and counterparty limits set out in the approved investment strategy. Investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

5.3 The in-house treasury management team together with the Council's advisors Capita continually monitors the credit ratings assigned to the institutions it uses when placing investments and during the year there was very little movement in these highlighting the continuing drive by financial institutions to realign their balance sheets following the economic downturn.

5.4 The graph below provides a breakdown of the Council's investments placed as at 31 March 2017 by long term credit rating and further information detailing the make-up of this can be found at Appendix C & D;



5.5 Following the outcome of the June 2016 Brexit referendum, the UK's Bank Rate was cut from 0.5% to 0.25% on 4 August where it currently remains with Market expectations currently forecasting that the timing of the start of monetary tightening will now commence around quarter 4 2019. Deposit rates started 2016/17 at their depressed levels but then continued to fall even further after the 4 August MPC meeting and whilst rates made a weak recovery towards the end of 2016 they once again fell to fresh lows in March 2017.

5.6 The Council's main bank account with Barclays, is non-interest bearing and consequently if no investments were undertaken by the in-house team, the Council would lose the opportunity to generate a substantial amount of income.

5.7 Investments placed by the Council consist of funds placed for both short and long term gain and the level of return achieved in 2016/17 on short term investments was 0.67%. Whilst this was below that originally budgeted for of 0.90%, it was 0.46% or £(0.5m) above the comparable performance indicator of the average 7-day London Interbank BID (LIBID) rate, of 0.21% and £(0.2)m above budget.

5.8 The higher than forecasted level of investment interest achieved in 2016/17 was as a result of the;

- in-house team placing a proportion of investments with institutions early in the year prior to the MPC reducing the bank rate and
- level of balances being available for investment being higher than originally forecasted due to external grants & contributions being received ahead of spend requirement and re-phasing of projects within the capital programme.

5.9 A maturity profile of the Council's temporary investments can be found at Appendix C together with a further breakdown at Appendix D which details the historic risk of default.

5.10 With regards to the Council's long term investments, in 2015, £5m was placed into the Church Commissioners Local Authority Property Fund for a minimum period of 5 years which after entry costs had been deducted of £0.3m, enabled 1,643,872 units to be purchased in the fund. At 31 March 2017 the value of these units, were worth £4.7m and this compares to the valuation at 31 March 2016 of £4.8m.

5.11 The reduction in valuation of £0.1m is in response to the Brexit referendum outcome in June 2016 when the demand in commercial property transactions slowed. Since then however as a result of growing confidence from overseas buyers, a gradual recovery is currently being encountered in this sector but valuations still remain below the levels achieved earlier in 2016.

5.12 Annualised returns generated from the property fund in 2016/17 (net of fees) was 4.61% and this compares with that achieved in 2015/16 of 4.83%.

5.13 When the rates of return for both short and long term investments are combined, this generates an average level invested of £105.6m, producing a rate of return of 0.87%.

5.14 The ability to generate a satisfactory level of return without exposing the Council to high levels of risk during the continuing climate of low interest rates remains challenging and new ways of being able to do this are constantly being sought.

6. RELATED TREASURY ISSUES

6.1 Member training – In accordance with the Code, Members are responsible for ensuring effective scrutiny of the treasury management strategy and policies takes place and in order to be able to do so effectively a Member training session was undertaken in January 2017.

6.2 Local Authority Mortgage Scheme – the Council participated in the national Local Authority Mortgage Scheme using the cash backed option with Lloyds bank by advancing £2m in 2012/13 at an interest rate of 4.41% which is due to be repaid back to the Council in 2017/18. Due to the success of this scheme, a further £1m was also advanced in 2013/14 at an interest rate of 2.7%, which is set to mature in 2018/19. These are classified as being service investments, rather than a treasury management investment, and are therefore outside of the specified / non specified investment categories.

7. PRUDENTIAL AND PERFORMANCE INDICATORS

7.1 Within the Treasury Management Strategy for 2016/17, approval was given to the treasury management prudential & performance indicators for the period 2016/17 – 2019/20. All indicators and benchmarks set for 2016/17 were complied with and details of these are shown in Appendix E.

Other Options

This report has been produced in order to comply with Finance Procedure Rules and relevant legislation and provides an overview of the treasury management transactions undertaken during 2016/17.

Consultation

Advice has been obtained from Capita, the Council's external advisors.

Reasons for Recommendation

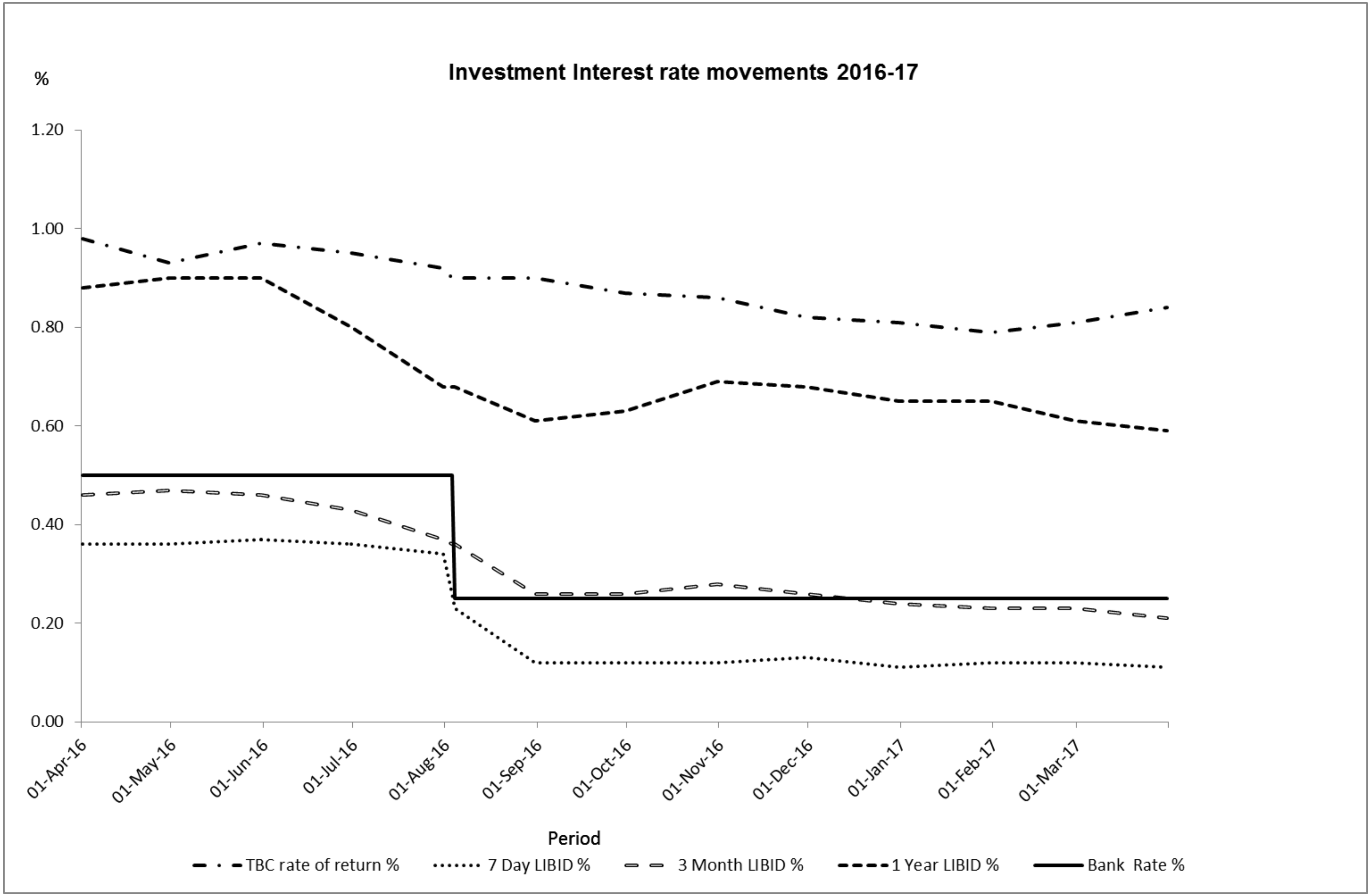
The report has been produced in order to meet the requirements of the Council's Financial Procedure Rules which incorporate the requirements of both the CIPFA Prudential Code for Capital Finance and the CIPFA Code of Practice on Treasury Management.

Finance Officer Clearance *…GB …*

Legal Officer Clearance ......JLF...

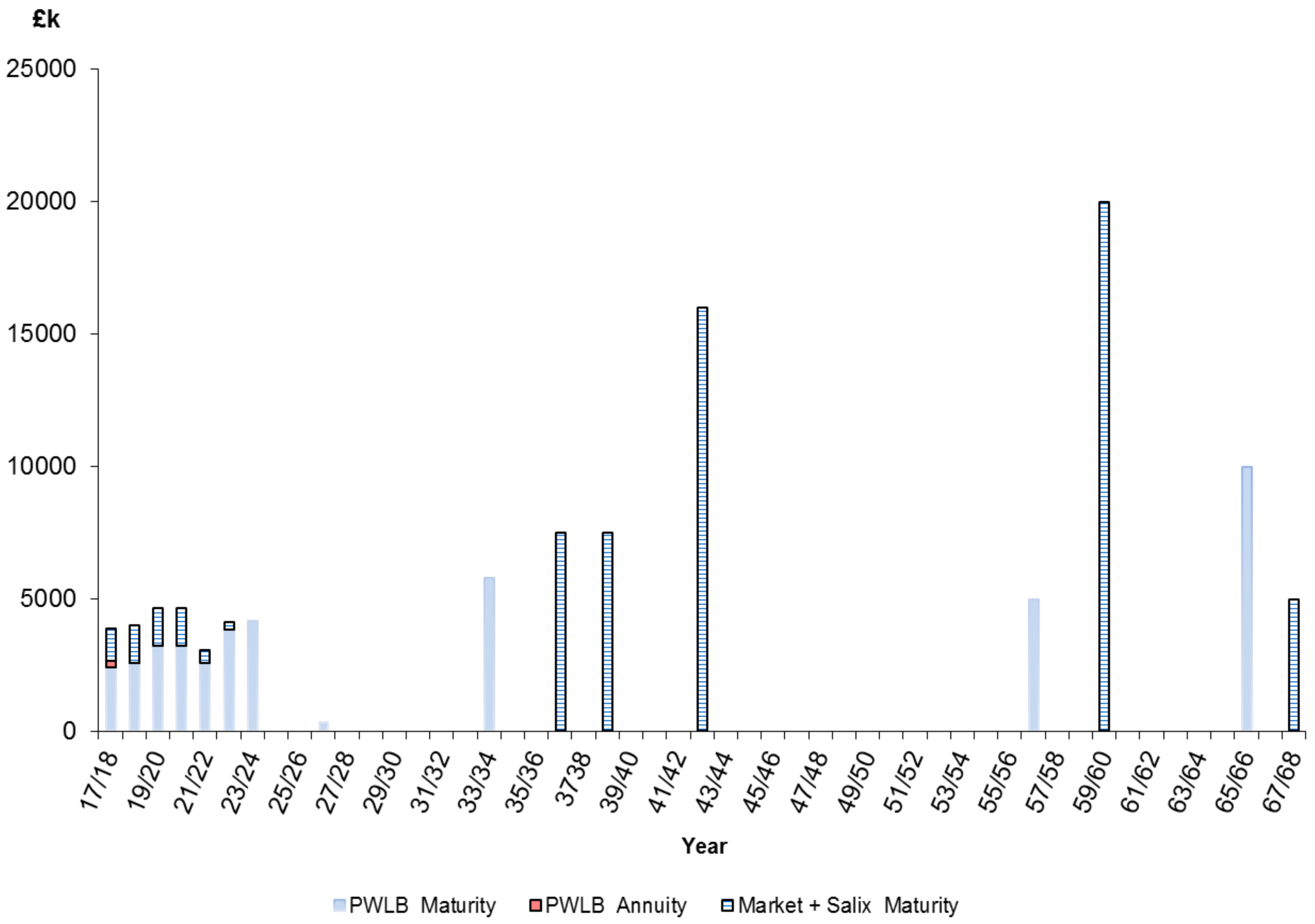
DIRECTOR'S SIGNATURE ………

Appendix A



Investment Interest rate movements 2016-17
%
1.20
1.00
0.80
0.60
0.40
0.20
0.00
01-Apr-16
01-May-16
01-Jun-16
01-Jul-16
01-Aug-16
01-Sep-16
01-Oct-16
01-Nov-16
01-Dec-16
01-Jan-17
01-Feb-17
01-Mar-17
Period
TBC rate of return %
7 Day LIBID %
3 Month LIBID %
1 Year LIBID %
Bank Rate %

Profile of debt outstanding as at 31.03.2017



Appendix B

Appendix C

Maturity Profile

Debt portfolio:

	31 March 2017 (£m)	31 March 2016 (£m)
Under 12 months	3.9	3.7
12 months and within 24 months	4.0	2.9
24 months and within 5 years	12.1	9.8
5 years and within 10 years	8.4	10.6
10 years and above	76.8	77.2
Total	**105.2**	**104.2**

Investment portfolio:

	31 March 2017 (£m)	31 March 2016 (£m)
Instant Access	19.3	37.7
Up to 3 Months	22.0	5.5
3 to 6 Months	24.1	16.7
6 to 9 Months	7.8	9.5
9 to 12 months	4.5	7.6
Over 1 year	£4.7	4.8
Total	**82.4**	**81.8**

Appendix D

Breakdown of Investments as at 31 March 2017

Counterparty	Amount £	Interest rate	Long Term Credit Rating
Barclays Bank	2,000,000	0.78%	A
Church Commissioners Local Authority	4,739,612	4.47%	Not rated
Close Brothers Bank	2,500,000	0.80%	A
Federated Investors – Money Market Fund	960,000	0.27%	AAA
Goldman Sachs Bank	2,500,000	0.75%	A
Invesco Aim – Money Market Fund	15,690,000	0.31%	AAA
Leeds Building Society	2,500,000	0.83%	A-
Leeds City Council	3,000,000	0.30%	AA
Leeds City Council	2,000,000	0.30%	AA
Lloyds Bank	1,500,000	1.00%	A+
Lloyds Bank	2,000,000	0.80%	A+
Lloyds Bank	400,000	1.05%	A+
Nationwide BS	2,200,000	0.61%	A+
Nationwide BS	2,800,000	0.63%	A+
Salford City Council	3,000,000	0.30%	AA
Santander UK Bank	3,000,000	0.48%	A
Santander UK Bank	2,000,000	0.67%	A
Standard Life – Money Market fund	2,650,000	0.29%	AAA
Sumitumo Mitsui Bank	5,000,000	0.46%	A-
Total UK	**60,439,612**	**0.81%**	
National Bank of Abu Dhabi	1,500,000	0.41%	AA-
National Bank of Abu Dhabi	2,000,000	0.52%	AA-
National Bank of Abu Dhabi	3,000,000	0.73%	AA-
National Bank of Abu Dhabi	2,500,000	0.56%	AA-
Qatar National Bank	2,000,000	0.78%	AA-
Qatar National Bank	2,000,000	0.81%	AA-
Qatar National Bank	2,000,000	0.78%	AA-
Qatar National Bank	2,000,000	0.77%	AA-
Qatar National Bank	2,000,000	0.69%	AA-
United Overseas Bank	3,000,000	0.60%	A
Total Non UK	**22,000,000**	**0.67%**	
Grand Total	**82,439,612**	**0.77%**	

Appendix E

Prudential Indicators for 2016/17

Indicator	Original	Actual
Authorised Borrowing Limit Maximum level of external debt, including other long term liabilities (PFI & leases) undertaken by the authority including any temporary borrowing - this is a statutory limit under Section 3(1) of the Local Government Act 2003.	£151.8m	£110.8m
Operational Boundary Calculated on a similar basis as the authorised limit but represents the expected level of external debt & other long term liabilities (PFI & leases) excluding any temporary borrowing – this is not a limit.	£135.8m	£110.8m
Upper limits on fixed interest rates **Maximum** limit of net fixed interest rate exposure - debt less investment	£3.1m	£3.0m
Upper limits on variable interest rates **Maximum** limit of net variable interest rate exposure – debt less investment	£3.3m	£2.8m
Gross debt and Capital Financing Requirement This highlights that all gross external borrowing, including PFI & leases will only be for capital purposes and that this does not exceed the capital financing requirement. Figures reflect amount capital financing requirement which exceeds gross external borrowing.	£8.2m	£33.2m
Maturity structure of fixed rate borrowing These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing and are required for upper and lower limits.		
Under 1 year (this includes the next call date for Market loans)	70%	42%
1 year to 2 years	30%	4%
2 years to 5 years	30%	11%
5 years to 10 years	30%	8%
10 years to 20 years	30%	5%
20 years to 30 years	30%	15%
30 years to 40 years	30%	5%
40 years and above	35%	10%
Maximum principal funds invested exceeding 364 days (including Manchester International Airport shares) - (These limits are set to reduce the need for early sale of an investment)	£100m	£48.4m

Performance Indicators for 2016/17

Indicator	Target	Actual
Security – potential default rate of the Council's investment portfolio based on default rates from the 3 main credit rating agencies – inclusion is recommended by CIPFA.	Max 0.077%	Max 0.012% (31 March 2017)
Liquidity – investments available within 1 week notice	£15m min.	Achieved
Liquidity – Weighted Average Life of investments	6 months	2.7 months at 31 March 2017
Yield – Investment interest return to exceed 7 day **L**ondon **I**nterbank **BID** rate	0.20% (Avg. 7 day LIBID)	0.87%
Origin of investments placed - maximum investments to be directly placed with non-UK counterparties.	UK institutions 100% Non UK institutions 40%	Min 62% Max 38%