

TELFORD & WREKIN COUNCIL

AUDIT COMMITTEE – 27 JUNE 2017

TREASURY MANAGEMENT - 2016/17 ANNUAL REPORT AND 2017/18 UPDATE

REPORT OF THE ASSISTANT DIRECTOR: FINANCE & HR (CHIEF FINANCIAL OFFICER)

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PART A) – SUMMARY REPORT

1. SUMMARY OF MAIN PROPOSALS

The report updates members on the outcome of Treasury Management activities for 2016/17 and details the position for 2017/18 to date.

2016/17 Treasury Outturn

The treasury portfolio ended the year with net indebtedness of £200.1m (borrowing: £220.0m less investments: £19.9m (excluding NuPlace Share capital). Base rate was 0.25% for the whole year and is predicted to stay at 0.25% until 2020.

The borrowing strategy for 2016/17 was to borrow temporarily to take advantage of low interest rates where possible and review opportunities for new longer term borrowing as appropriate. Borrowing was £55.9m higher at 31 March 2017 compared to 31 March 2016, however investments were also £12.7m higher (excluding NuPlace share capital). The net increase in net indebtedness was due to capital expenditure, including on income generating schemes such as NuPlace and the Property Investment Portfolio as well as various highways schemes which have increased the value of Council assets. Short term borrowing was used during the year at favourable interest rates generating a significant benefit for the Council's budget.

The investment strategy for 2016/17 was to gain maximum benefit with security of capital being the key consideration. The average return on investments for the year was 0.26% against a benchmark of 0.23%.

Overall, treasury delivered a net over-achievement of £4.011m against the budget set for 2016/17. The majority of the saving relates to the benefit of low interest rates on the levels of temporary borrowing we held during the year. It also includes £0.174m generated as a one-off saving in 2016/17 as a result of capitalisation of interest on capital projects pending their completion.

2017/18 Update

The strategy for 2017/18 remains consistent with that of the previous year. Investment opportunities will be reviewed as they arise and we will seek to gain maximum benefit within the agreed risk parameters. There are currently no long term investments, which reduces counter-party risk and also reduces net interest costs as longer-term borrowing costs tend to be greater than we are able to earn on new investments.

Based on the capital programme, borrowing will be required during the year and consideration will be given to the maturity profile of current debt, interest rates and refinancing risks as well as the source, which is primarily expected to be the Public Works Loans Board or potentially forward fixed market fixed-rate loans.

Total borrowing was £220.0m at 31/3/17 and has reduced to £200.1m as at 31 May 2017. Investments were £5.8m at 31 May 2017.

2. RECOMMENDATIONS

Audit Committee Members are asked to:-

- 2.1 note the contents of the report
- 2.2 note the performance against Prudential Indicators.

3. *SUMMARY IMPACT ASSESSMENT*

<i>COMMUNITY IMPACT</i>	Do these proposals contribute to specific priority plan objectives? Yes/ No Efficient Community Focussed Council Will the proposals impact on specific groups of people? Yes/ No
<i>TARGET COMPLETION / DELIVERY DATE</i>	Part of ongoing Treasury Management Activities within the Treasury Management Strategy and Policy approved by Council.
<i>FINANCIAL/VALUE FOR MONEY IMPACT</i>	Yes/ No Where appropriate these are detailed in the body of the report.
<i>LEGAL ISSUES</i>	Yes/ No The AD: Finance & HR (Section 151 Officer), has responsibility for the administration of the financial affairs of the Council. In providing this report the Section 151 Officer is meeting one of the responsibilities of the post contained within the Council's Constitution at Part 2, Article 12, paragraph 12.04(f) which states "The Chief financial Officer will contribute to the promotion and maintenance of high standards of governance, audit, probity and propriety, risk management and the

approval of the statement of accounts through provision of support to the Audit Committee.”

**OTHER IMPACTS,
RISKS AND
OPPORTUNITIES**

Yes/No

The key opportunities and risks associated with treasury management activities are set out in the body of the report and in the Treasury Management Strategy and Policy approved by Council and will be regularly monitored throughout the year.

**IMPACT ON
SPECIFIC WARDS**

Yes/No

4. **PREVIOUS MINUTES**

Council 3 March 2016

Audit Committee 28 June 2016

Audit Committee 24 January 2017

Council 2 March 2017

PART B – ADDITIONAL INFORMATION

5. **BACKGROUND**

Treasury Management in local government is regulated by the 2001 revision of the CIPFA Treasury Management in Public Services: Code of Practice (the Code). This Council has adopted the Code and fully complies with its requirements. The primary requirement of the Code is the formulation and agreement by full Council of a Treasury Policy Statement, which states the policies and objectives of its treasury management activities.

A requirement of the Council’s Treasury Management Practices is the reporting to the Council of both the expected treasury activity for the forthcoming financial year (the annual treasury strategy statement) and subsequently the results of the Council’s treasury management activities in that year (this annual treasury report).

6. **2016/17**

The annual report is covered in paragraphs 6-15 and deals with: -

- 2016/17 Portfolio position;
- the borrowing strategy for 2016/17;
- the borrowing outturn for 2016/17;
- compliance with treasury limits;
- investments strategy for 2016/17;
- investments outturn for 2016/17;
- debt rescheduling;
- Shropshire Council debt
- overall outturn position
- leasing

7. 2016/17 PORTFOLIO POSITION

The Council's treasury management position at the beginning and the end of the year was as follows: -

	31 March 2016		31 March 2017	
	Principal £m	Rate %	Principal £m	Rate %
Borrowing	164.098	2.82	220.048	2.36
Investments (excluding NuPlace share capital)	7.189	0.42	19.943	0.26
Net Indebtedness (ex NuPlace)	(156.909)		(200.105)	
Investment in NuPlace	3.500		6.450	
Net Indebtedness	(153.409)		(193.655)	

There was new temporary borrowing and repayment of £1.5m PWLB during 2016/17 as well as new PWLB borrowing of £15m; temporary borrowing was £119.2m at 31 March 2017 (including £2.1m PWLB maturing in 2017/18). The capital programme was funded from a combination of borrowing, capital receipts, grants and other external contributions; this has resulted in an increase in net indebtedness during the year. Prudential borrowing increased in 2016/17 due to planned capital expenditure approved as part of the capital programme. Investments at 31/3/17 included £6.5m share capital in NuPlace.

The Adopted Treasury Strategy was to:-

- Monitor borrowing opportunities determined by the prevailing markets.
- Only investing short term to meet cashflow requirements.
- Reduce the volatility of investment returns while maintaining adequate flexibility in arrangements.
- To achieve optimum return on investments commensurate with proper levels of security and liquidity.

9. COUNCILS RESPONSE TO ECONOMIC CLIMATE

9.1 **Economic background:** Politically, 2016/17 was an extraordinary twelve month period which defied expectations when the UK voted to leave the European Union and Donald Trump was elected the 45th President of the USA. Uncertainty over the outcome of the US presidential election, the UK's future relationship with the EU and the slowdown witnessed in the Chinese economy in early 2016 all resulted in significant market volatility during the year. Article 50 of the Lisbon Treaty, which sets in motion the 2-year exit period from the EU, was triggered on 29th March 2017.

UK inflation had been subdued in the first half of 2016 as a consequence of weak global price pressures, past movements in sterling and restrained domestic price growth. However the sharp fall in the Sterling exchange rate following the referendum had an impact on import prices which,

together with rising energy prices, resulted in CPI rising from 0.3% year/year in April 2016 to 2.3% year/year in March 2017.

In addition to the political fallout, the referendum's outcome also prompted a decline in household, business and investor sentiment. The repercussions on economic growth were judged by the Bank of England to be sufficiently severe to prompt its Monetary Policy Committee (MPC) to cut the Bank Rate to 0.25% in August and embark on further gilt and corporate bond purchases as well as provide cheap funding for banks via the Term Funding Scheme to maintain the supply of credit to the economy.

Despite growth forecasts being downgraded, economic activity was fairly buoyant and GDP grew 0.6%, 0.5% and 0.7% in the second, third and fourth calendar quarters of 2016. The labour market also proved resilient, with the ILO unemployment rate dropping to 4.7% in February, its lowest level in 11 years.

Following a strengthening labour market, in moves that were largely anticipated, the US Federal Reserve increased rates at its meetings in December 2016 and March 2017, taking the target range for official interest rates to between 0.75% and 1.00%.

Financial markets: Following the referendum result, gilt yields fell sharply across the maturity spectrum on the view that Bank Rate would remain extremely low for the foreseeable future. After September there was a reversal in longer-dated gilt yields which moved higher, largely due to the MPC revising its earlier forecast that Bank Rate would be dropping to near 0% by the end of 2016. The yield on the 10-year gilt rose from 0.75% at the end of September to 1.24% at the end of December, almost back at pre-referendum levels of 1.37% on 23rd June. 20- and 50-year gilt yields also rose in Q3 2017 to 1.76% and 1.70% respectively, however in Q4 yields remained flat at around 1.62% and 1.58% respectively.

After recovering from an initial sharp drop in Q2, equity markets rallied, although displaying some volatility at the beginning of November following the US presidential election result. The FTSE-100 and FTSE All Share indices closed at 7342 and 3996 respectively on 31st March, both up 18% over the year. Commercial property values fell around 5% after the referendum, but had mostly recovered by the end of March.

Money market rates for overnight and one week periods remained low since Bank Rate was cut in August. 1- and 3-month LIBID rates averaged 0.36% and 0.47% respectively during 2016-17. Rates for 6- and 12-months increased between August and November, only to gradually fall back to August levels in March, they averaged 0.6% and 0.79% respectively during 2016-17.

Credit background: Various indicators of credit risk reacted negatively to the result of the referendum on the UK's membership of the European Union. UK bank credit default swaps saw a modest rise but bank share prices fell sharply, on average by 20%, with UK-focused banks experiencing the largest falls. Non-UK bank share prices were not immune, although the fall in their share prices was less pronounced.

Fitch and Standard & Poor's downgraded the UK's sovereign rating to AA. Fitch, S&P and Moody's have a negative outlook on the UK. Moody's has a negative outlook on those banks and building societies that it perceives to be exposed to a more challenging operating environment arising from the 'leave' outcome.

None of the banks on the Authority's lending list failed the stress tests conducted by the European Banking Authority in July and by the Bank of England in November, the latter being designed with more challenging stress scenarios, although Royal Bank of Scotland was one of the weaker banks in both tests. The tests were based on banks' financials as at 31st December 2015, 11 months out of date for most. As part of its creditworthiness research and advice, the Authority's treasury advisor Arlingclose regularly undertakes analysis of relevant ratios - "total loss absorbing capacity" (TLAC) or "minimum requirement for eligible liabilities" (MREL) - to determine whether there would be a bail-in of senior investors, such as local authority unsecured investments, in a stressed scenario.

- 9.2 The Council has continued to maintain short duration and relatively low level of investments during 2016/17. This reduces exposure to investment risk.
- 9.3 We have closely followed investment guidance issued by our Treasury Advisors in relation to credit ratings, financial standing and duration and take advice on borrowing strategies and options.

10. **BORROWING 2016/17**

10.1 **Original Economic Projections**

The Expectation for Interest Rates – When the budget was set for 2016/17 the “average” City view anticipated that Bank Rate would remain at 0.5% until 2018 before starting to rise gradually back towards more normal levels, though Bank Rate would take a long time to return to a normalised level of the Bank Rate post-crisis to range between 2.5% and 3.5%.

10.2 **Outturn 2016/17**

During 2016/17 the Monetary Policy Committee (MPC) was initially focused on helping the economy to recover, but with inflation rising. Then as a result of the vote to exit from the European Union, the MPC ended up cutting base rate and increasing the level of quantitative easing.

Base rate was cut to 0.25% and is expected to stay there for some time. Inflation is continuing to rise. Gilt yields fell considerably after the EU referendum result. This led to cheaper borrowing which the Council was able to take advantage from due to the level of temporary borrowing being held.

Borrowing and Investment Rates in 2016/17

The overnight investment rate fell after the cut in base rate and has remained low since.

Treasury Borrowing and Rescheduling

The borrowing strategy for the current year was to borrow temporarily to take advantage of low interest rates where possible and review opportunities for new longer term borrowing as appropriate.

During the year we borrowed three new PWLB loans for £15.0m at the certainty rate and we had maturities totalling £1.5m.

PWLB Repayments & Discounts

No loans were repaid early or rescheduled during the year.

An analysis of the maturity structure of our debt is shown below. The maturing in less than 1 year includes £2.098m of PWLB loans.

Analysis of Debt Maturity as at 31st March

	2016 £'000	%	2017 £'000	%
Maturing in less than 1 year	75,579	29.5	119,175	54.2
Maturing in 1-2 years	1,001	0.8	2,097	0.9
Maturing in 2-5 years	2,503	2.4	4,793	2.2
Maturing in 5-10 years	7	1.2	5,241	2.4
Maturing in more than 10 years*	<u>85,008</u>	66.1	<u>88,742</u>	40.3
	<u>164,098</u>	100.0	<u>220,048</u>	100.0

* this includes £45m LOBO (Lenders Option Borrowers Option) loans that are potentially callable at certain points before the maturity date. There is therefore the potential that these loans would have to be replaced sooner exposing the council to the prevailing market at that time. To-date, none of our LOBOs have been called before maturity and current expectations are that calls in the foreseeable future are unlikely. This is less than we had at 31st March 2016 as £15m were converted, at no cost to the Council, into maturity loans.

Debt Performance

As highlighted in section 7 the average debt portfolio rate has fallen over the course of the year from 2.82% to 2.36%. This is due to the increase in temporary borrowing being undertaken in 2016/17 at low interest rates as compared to 2015/16.

11. COMPLIANCE WITH TREASURY LIMITS

During the financial year the Council operated within the Treasury Limits and Prudential Indicators set out in the Council's Treasury Policy Statement and annual Treasury Strategy Statement

12. INVESTMENTS 2016/17

12.1 Strategy

Internally Managed Investments - The authority currently manages all of its investments in-house and invests within the institutions complying with its counterparty limits and credit rating requirements. All investments are

short term related to cash flows in order to minimise counterparty risk and to minimise overall treasury management costs.

Investment Strategy - The agreed short term investment strategy for 2016/17 was to achieve optimum return on investments commensurate with proper levels of security and liquidity.

12.2 Outturn 2016/17

Detailed below are the results of the investment strategy undertaken by the Council, based on the average investment during the year.

	Average Investment	Rate of Return (gross of fees)	Rate of Return (net of fees)	Benchmark Return *
Internally Managed				
Investments	£15.773m	0.26%	0.26%	0.23%

*overnight rate

No institutions in which investments were made showed any difficulty in repaying investments and interest in full during the year.

13. SHROPSHIRE COUNCIL DEBT

The Council makes an annual contribution (£1.386m in 2016/17) towards Shropshire Council costs on pre disaggregation debt (i.e. pre unitary inception) - interest paid averaged 5.35% last year. The rate of interest paid on this is managed by Shropshire and is considerably higher than the rate payable by Telford & Wrekin Council on its borrowing. This has fallen since 2015/16 due mainly to a change in relation to minimum revenue provision made by Shropshire.

14. OVERALL OUTTURN FOR 2016/17

The net overall position is summarised in the table below. The sound overall position has resulted from a mix of cash flow benefits plus proactive treasury management activities. The budget reflected the position when the budget was set, the underspend has been achieved through active management of borrowing and the low interest rates prevailing for the year. Overall a net saving of £4.0m was made against budget for the year which is summarised below:

Summary of Outturn Position

	Estimate £m	Outturn £m	Variance £m
Interest Received	(0.15)	(0.05)	0.10
Principal Repayments	0.00	0.00	0.00
MRP saving from change of policy re PFI	(2.21)	(2.21)	0.00
Capitalisation of Interest	(0.0)	(0.17)	(0.17)
Shropshire County Council	1.69	1.39	(0.30)
Interest Paid	<u>7.26</u>	<u>3.62</u>	<u>(3.64)</u>
Net Position	6.59	2.58	(4.01)

15 **LEASING**

Each year the Council arranges operating leases for assets such as vehicles, computers and equipment. This helps spread the cost over a number of years in line with the anticipated life of the equipment.

The final drawdown for 2016/17 was completed in March. The drawdown consisted of a finance lease from JCB Finance totalling £0.186m and funded the purchase of ICT equipment over three years at an interest rate of 0.98%.

16. **2017/18 UPDATE**

The remainder of this report deals with the current financial year based largely on information to 31 May 2017.

16.1 **Strategy**

The strategy for 2017/18 is to continue to keep investments as short term, where possible, to reduce the need to borrow thus reducing investment exposure and maximising overall returns to the revenue account. We will review investment opportunities if they arise and also review borrowing opportunities as we progress through the year and look to take advantage of advantageous interest rates where appropriate. 2017/18 and 2018/19 will see the Council continue to invest in significant regeneration projects including highways and building homes and commercial property for rent as part of the approved Housing Investment Programme

16.2 **Interest Rates**

Base rate began the year at 0.25% and has remained there. The current expectation is that there will be no increase before mid 2020.

16.3 **Prudential Regime**

This Council agreed its required indicators at Council on 2 March 2017. There have been no breaches of the indicators and none have been amended. The Council set itself an Operational limit for external debt of £390m for 2017/18 and an Authorised limit of £411m. Our total borrowing outstanding as at 31/05/17 (including PFI) is £200m which is within both limits.

16.4 **Borrowing**

We have taken two New PWLB loans during in 2017/18 both are 10 year Equal Instalments of Principal and £10m at rates of 1.22% and 1.20% and have had no maturities to-date. In total we have £3.1m maturing during 2017/18.

16.5 **Internally Managed Investments**

The strategy for the year is to gain maximum benefit at minimum risk whilst achieving as a minimum, the overnight deposit rate. For the period to 31 May 2017 some £512m worth of investments have been made in our overnight call accounts. Rates have ranged from 0.15% to 0.20%. As at 31 May 2017 internal investments stood at £5.77m.

Potentially the Council can place up to £15.0m with any Counterparty. At the end of May the greatest exposure with a single counterparty was £2.21m with Lloyds Bank (38.4% of the portfolio). £2.1m was invested with a non UK sovereign institution. A detailed breakdown is shown in Appendix 2.

The Council is currently working with its Treasury Advisors to select a money market fund investment portal to give increased diversification of counter-party risk and slightly higher yield whilst retaining a high degree of liquidity.

16.6 Non UK Sovereign Counterparty Limits

At present we have a non UK sovereign counterparty limit set at £15m.

17 Background Papers

CIPFA Code of Practice for Treasury Management in Local Authorities;
Fund Manager Valuations; Temporary Borrowing records; PWLB
records
Investment records

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PRUDENTIAL INDICATORS

PRUDENTIAL INDICATOR	2015/16	2016/17	2016/17
(1). EXTRACT FROM BUDGET AND RENT SETTING REPORT	£m	£m	£m
	Actual Outturn	Original Estimate	Actual Outturn
Capital Expenditure			
TOTAL	74.5	98.9	73.7
Ratio of financing costs to net revenue stream			
General fund	2.88%	4.96%	3.67%
Net borrowing requirement			
brought forward 1 April	116.6	163.9	164.1
carried forward 31 March	164.1	216.2	220.0
in year borrowing requirement	+47.5	+52.3	+55.9
Capital Financing Requirement as at 31 March			
TOTAL	335.6	403.2	367.8
Annual change in Cap. Financing Requirement			
TOTAL	+40.1	+54.5	+32.2
Incremental impact of capital investment decisions	£ p	£ p	£ p
Increase in council tax (band D) per annum (not cumulative)	22.08	27.01	27.01

PRUDENTIAL INDICATOR	2015/16	2016/17	2016/17
(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	£m	£m	£m
	final	original	final
Authorised limit for external debt - borrowing	327	330	330
other long term liabilities	63	62	62
TOTAL	390	392	392
Operational boundary for external debt - Borrowing	309	310	310
other long term liabilities	61	60	60
TOTAL	370	390	390
Upper limit for fixed interest rate exposure Net principal re fixed rate borrowing / investments	100	100	100
Upper limit for variable rate exposure Net principal re variable rate borrowing / investments:-	30%	30%	30%
Upper limit for total principal sums invested for over 364 days (per maturity date)	95%	95%	95%

Maturity structure of fixed rate borrowing during 2016/17	lower limit	upper limit
under 12 months	0%	70%
12 months and within 24 months	0%	30%
24 months and within 5 years	0%	50%
5 years and within 10 years	0%	75%
10 years and above	25%	100%

Summary of Investments at 31 May 2017

	Sovereign Credit Rating	Individual credit Rating	Total £m	%
Call Accounts				
Lloyds Svenska	UK AA	F1 A+ support 5 viability a	2.213	38.4
Handelsbanken	SWE AAA	F1+AA support 5 viability aa	2.132	37.0
Santander	UK AA	F1 A support 2 viability a	1.422	24.6
			5.767	100.0
Fixed Deposits				
			0	
			0.000	0.0
Variable Deposit				
			0	
Total			5.767	100.0
Non UK holding £2.1m (Limit £15m)				