TREASURY MANAGEMENT STEWARDSHIP ANNUAL REPORT 2016/17

Report of the County Treasurer

Please note that the following recommendations are subject to consideration and determination by the Committee before taking effect.

Recommendation: that the Committee notes the report and considers whether it wishes to make any further comments to Cabinet.

1. Introduction

1.1. The County Council has adopted the CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management in the Public Services. A revised Code of Practice was published by CIPFA in November 2011 and a revised Policy Statement and Treasury Management Practices (TMPs) were agreed by Council in February 2016. The Treasury Management and Investment Strategy for 2016/17 was agreed by Council in February 2016 and forms part of the published budget book.

1.2. The purpose of this report is to show the outturn position, review performance and inform members of any key matters arising from the Council's Treasury and Debt Management activities during the 2016/17 financial year. The report also includes an update on the 2017/18 Strategy. This report, together with any comments offered by this committee, will be considered by Cabinet on 12th July.

2. Minimum Revenue Provision

2.1. Each year the Council has a statutory obligation to charge to the revenue account an annual amount of Minimum Revenue Provision (MRP), which is a charge to make provision for the repayment of the authority's external debt and internal borrowing. The charge is based on the historic borrowing required to fund the Council's capital programme.

2.2. The current policy, following a review in 2015/16 is to charge MRP in equal instalments over the life of the asset benefiting from the capital spend. The final outturn for MRP for 2016/17 is £20.3m.

3. Treasury Management Outturn Position 2016/17 - Borrowing

3.1. The overall aims of the borrowing strategy are to achieve:

- Borrowing at the lowest rates possible in the most appropriate periods;
- The minimum borrowing costs and expenses;
- A reduction in the average interest rate of the debt portfolio.

3.2. The Medium Term Financial Strategy assumption was that no new long-term borrowing would be required, although this would be kept under review. This has been made possible by the current capital financing regime, whereby the Government now provides capital grants rather than supported borrowing, and prudent management of the capital programme.

3.3. Active treasury management and the maintenance of levels of liquidity aim to avoid the need for short term borrowing. Cash positions are monitored daily and modelled over a monthly horizon to ensure that anticipated liquidity levels are forecast accurately.

3.4. However, the identification of temporary shortfalls in available cash meant that short-term borrowing was required for brief periods at the end of June and October. Three short-term loans totalling £10m were undertaken from other local authorities, each for a period of less than 30 days and at an average rate of 0.31%. The total amounts borrowed were not required for the full term of each loan and we were able to invest the surplus funds at a higher rate resulting in a small net gain to the authority. No further short-term borrowing was required during 2016/17.

3.5. In accordance with the Medium Term Financial Strategy, no long term borrowing was undertaken during this financial year. Instead all borrowing required to fund capital expenditure was met from internal cash balances. This position will be kept under review, but the expectation remains that no new external borrowing will be required during the three year period.

3.6. No opportunities arose during the 2016/17 financial year to repay outstanding debt without incurring substantial premium penalties, which would negate any benefit of repaying the debt. The Public Works Loan Board (PWLB) sets premature repayment rates, and where the interest rate payable on a current loan is higher than the repayment rate, the PWLB policy imposes premium penalties for early repayment. With current low rates of interest these penalties would be of a significant cost. Therefore it will only make financial sense to repay debt early if the PWLB changes its current policy, or if interest rates rise and cancel out the repayment premiums.

3.7. At 31st March 2017 the level of long term debt stood at £507.85m as detailed in the table below.

Analysis of Long Term Debt

	Actual 31.03.16 £'m	Interest Rate %	Current 31.03.17 £'m	Interest Rate %
Fixed Rate Debt				
PWLB	436.35	4.99	436.35	4.99
Money Market	71.50	5.83	71.50	5.83
Variable Debt				
PWLB	0.00		0.00	
Money Market	0.00		0.00	
Total External Borrowing	**507.85**	**5.11**	**507.85**	**5.11**

3.8. The long term debt figure presented in the Statement of Accounts for 2016/17 is £511.318m (£3.47m greater than the figure stated above). This difference is due to an accounting standard adjustment which requires us to record the value of our long term debt at its Net Present Value in the Statement of Accounts. The LOBOs (Lender Option Borrower Option) have stepped interest rates and are revalued annually based on the effective interest rate for the duration of the loan. This revaluation has the effect of smoothing the stepping of the interest over the life of the loans.

4. Treasury Management Outturn Position 2016/17 - Investments

4.1. The overall aim of the Council's investment strategy is to:

- Limit the risk to the loss of capital;
- Ensure that funds are always available to meet cash flow requirements;
- Maximise investment returns, consistent with the first two aims;
- Review new investment instruments as they come to the Local Authority market, and to assess whether they could be a useful part of our investment process.

4.2. Following the outcome of the EU referendum in June, the Bank of England was concerned about the impact of the result on the wider economy. They therefore decided to reduce the base rate from 0.5% to 0.25%. As a result of this and other global concerns that have impacted on banks, the rates that are now available have fallen further from the already low rates available in the market. The rates on offer during 2016/17 and going forward into 2017/18 continue to be low and the returns on the County Council's cash investments are forecast to remain at the current low levels for the foreseeable future; however, the Treasury Management Strategy will continue to ensure a prudent and secure approach.

4.3. However, the Council has benefitted from higher rates achieved on four one year loans made in the months before the referendum. The use of money market funds, provided for in the 2016/17 strategy has also assisted in providing slightly higher rates for liquid cash than traditional bank call accounts. Money market funds can include both Constant Net Asset Value (CNAV) funds and Variable Net Asset Value (VNAV) funds, but must be AAA rated.

4.4. As a result, the average interest rate earned on investments, excluding the CCLA property fund, for the year was 0.66%, against a full year budget target return of 0.65%. The CCLA property fund has yielded an average rate of 4.57% for the same period against a full year budget target of 4.5%. The combined total return from all investments was 0.98%.

4.5. Revenue lending during 2016/17, including the use of term deposits, call accounts and property funds, earned interest of £1.315m against a full year budget of £1.215m. The interest figure quoted is the return from the Council's Treasury Management activity and is different from the figure presented in the Outturn Report and the Statement of Accounts which also includes interest generated from a number of other sources.

4.6. All lending has been carried out in accordance with the Council's Treasury Management Strategy and with institutions on the list of approved counterparties.

4.7. The following table shows the County Council's fixed and variable rate investments as at the start and close of the financial year:

Schedule of Investments

	Maturing in:	Actual 31.03.16 £'m	Interest Rate %	Current 31.03.17 £'m	Interest Rate %
Bank and Building Society Deposits					
Fixed Rates					
Term Deposits	< 365 days	45.00	0.84	66.50	0.66
	365 days & >	0.00		0.00	
Callable Deposits					
Variable Rate					
Notice Accounts		50.00	0.70	30.00	0.75
Call Accounts		23.80	0.41	0.00	
Money Market Funds (MMFs)				20.74	0.29
Property Fund		10.00	4.67	10.00	4.45
All Investments		**128.80**	**1.00**	**127.24**	**0.92**

4.8. The figure as at 31st March 2017 includes approximately £14.3m related to the Growing Places Fund (GPF). This figure was approximately £14.6m as at 31st March 2016. Devon County Council is the local accountable body for the GPF, which was established by the Department for Communities and Local Government to enable the development of local funds to address infrastructure constraints, promoting economic growth and the delivery of jobs and houses. The Council is working in partnership with the Local Economic Partnership, and interest achieved on the GPF funds, based on the average rate achieved by the Council's investments, will accrue to the GPF and not to the County Council.

5. Prudential Indicators

5.1. Linked to its Treasury Management Strategy, the County Council is required to monitor its overall level of debt in line with the CIPFA Code of Practice. Part of the code requires consideration of a set of Prudential Indicators in order to allow the Council to form a judgement about the affordable, prudent and sustainable level of debt.

5.2. The purpose of the indicators is to demonstrate that:

- Capital expenditure plans are affordable;
- All external borrowing and other long term liabilities are within prudent and sustainable levels;
- Treasury management decisions are taken in accordance with professional good practice.

5.3. Three Prudential Indicators control the overall level of borrowing. They are:

- **The authorised limit** - this represents the limit beyond which any additional borrowing is prohibited until the limit is revised by the County Council. Revision may occur during the year if there are substantial and unforeseen changes in circumstances, for example, a significant delay in achieving forecast capital receipts. In normal circumstances this limit will not require revision until the estimate for the following year is revised as part of the budget setting process.
- **The operational boundary** – this indicator is based on the probable external debt and other long term liabilities during the year. Variations in cash flow may lead to occasional, short term breaches of the Operational Boundary that are acceptable.
- **The upper limit for net debt** - the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the Capital Financing Requirement.

5.4. During the Budget process, the following Borrowing Limits were set for 2016/17:

- Maximum borrowing during the period (Authorised Limit) £838.9m.
- Expected maximum borrowing during the year (Operational Limit) £813.9m.
- Underlying Borrowing Requirement to Gross Debt - £113.8m under borrowing.
- Maximum amount of fixed interest exposure (as a percentage of total) 100%.
- Maximum amount of variable interest exposure (as a percentage of total) 30%.

5.5. Members are asked to note that during 2016/17 the Council remained within its set Borrowing Limits and complied with the interest rate exposure limits.

6. 2017/18 Update

6.1. The Medium Term Financial Strategy assumes that, over the three year period, no new long-term borrowing will be required. This is still envisaged to be the case, although this will be kept under review.

6.2. The PWLB policy of imposing premium penalties for the early repayment of long term debt means there is little potential to repay further debt during the current financial year.

6.3. Forecasting future interest rates is difficult as the factors affecting interest rate movements are outside of the Council's control. Whilst short term rates are generally linked to the Bank of England's Base Rate, long term rates are determined by other factors, e.g. the market in Gilts. The County Council retains an external advisor, Capita, who forecast future rates several years forward. Similar information is received from a number of other sources.

6.4. There remains a high degree of uncertainty around the impact of the UK Brexit decision, the impact on the value of Sterling, and the potential inflation threat building in the UK economy. Interest rate expectations have been similarly affected, first pushing lower in anticipation of a near-term rate cut, to one where there is no expectation of any change in either direction for some while to come. This volatility could remain in situ for some time to come, certainly until there is greater clarity surrounding the consequences for the economy of the deal that can be negotiated around a withdrawal from the EU.

6.5. Markets had priced in no change in the UK Bank Rate until the close of 2019. However, in light of rising inflation and a more hawkish tone to commentary from the Bank of England Monetary Policy Committee, some commentators are now expecting a rate change by the close of 2018. As Brexit negotiations and price pressures unfold, such volatility in expectations will persist. However, the general consensus among market commentators is still that any future interest rate rises will be slow and gradual. Capita's current forecast is for the Bank of England to hold the current rate 0.25% to the end of 2019.

6.6. In consequence of the current market environment, the Council set a prudent target interest rate for 2017/18 for lending to banks and building societies of 0.40% p.a. with a target rate for the investment in the CCLA Property Fund of 4.5%. The Council will continue to invest its cash in a mixture of term deposits and more liquid call accounts and money market funds, and the target rates are considered to be achievable. The Treasury Management Strategy will continue to ensure a prudent and secure approach.

6.7. Consideration has been given to making a further investment in the CCLA Property Fund. While the income yield from the Fund continues to be stable at between 4% and 5% per year, the uncertainty of Brexit has meant that the outlook for commercial property prices is less certain, and there is a risk that the potential loss of capital would offset the benefit of the higher yields over the next five year period. It is not therefore proposed to increase the investment at this time, but this will be kept under review.

6.8. The Council currently has four money market fund managers on its counterparty list. Each of these providers offers a range of funds from CNAV (Constant Net Asset Value) funds which offer daily liquidity to VNAV (Variable Net Asset Value) enhanced cash funds which provide a slightly better rate and liquidity generally based on less than a week's notice. We will continue to make use of enhanced cash funds where possible to access the better rates, whilst ensuring the safety of the Council's cash. Money market funds must be AAA rated to comply with the Council's treasury management strategy.

7. Summary

7.1. No long term borrowing was undertaken during 2016/17. Three short-term loans totalling £10m were undertaken from other local authorities, each for a 30 day period at an average rate of 0.31%. It is not envisaged that any new long term borrowing will be required over the next three year period but this will be reviewed annually.

7.2. No opportunities arose during the 2016/17 financial year to repay outstanding debt without incurring substantial premium penalties, which would negate the benefit of repaying the debt.

7.3. Investment income of £1.315m was achieved in 2016/17 against a full year budget of £1.215m. This represented a return of 0.98%, including the Property Fund investment. Successful prudent management of the Council's short term cash reserves has delivered a surplus of £0.1m for the 2016/17 financial year.

Mary Davis

Electoral Divisions: All
Local Government Act 1972
List of Background Papers - Nil
Contact for Enquiries: Mark Gayler / Dan Harris
Tel No: (01392) 383621 Room G97/G99