APPENDIX A

Annual Treasury Management Review 2016/17

North Hertfordshire District Council
April 2017

Contents

Annual Treasury Management Review 2016/17

Purpose

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).

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 11/02/2016)
- a mid-year, (minimum), treasury update report (Cabinet 22/11/2016)
- an annual review following the end of the year describing the activity compared to the strategy, (this report)

In addition, Cabinet has received quarterly treasury management update reports.

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.

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 Finance, Audit and Risk Committee before they were reported to the full Council.

Executive Summary

During 2016/17, the Council complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

Prudential and treasury indicators	2015/16 Actual £'000	2016/17 Original £'000	2016/17 Actual £'000
Capital expenditure	3,524	8,619	5,686
Capital Financing Requirement:	-18,741	-15,738	-16,634
External debt	1,515	480	480
Investments			
• Longer than 1 year	7,750	0	7,000
• Under 1 year	30,275	23,500	29,000
• Total	38,025	23,500	36,000
Net borrowing	-36,510	-23,020	-35,520

Capital spend decreased during the year from an original budget of £8.62M to an actual of £5.69M. This was mainly due to the revision in the timetable for completion of schemes, and a net reduction on spend on other schemes.

Other prudential and treasury indicators are to be found in the main body of this report. The Director of Finance also confirms that no borrowing was undertaken for a capital purpose and the statutory borrowing limit, (the authorised limit), was not breached.

The financial year 2016/17 continued the challenging investment environment of previous years, namely low investment returns.

Recommendations

The Council is recommended to:

1. Approve the actual 2016/17 prudential and treasury indicators in this report
2. Note the annual treasury management report for 2016/17

Introduction and Background

This report summarises the following:-

- Capital activity during the year;
- Impact of this activity on the Council's underlying indebtedness, (the Capital Financing Requirement);
- The actual prudential and treasury indicators;
- Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances;
- Summary of interest rate movements in the year;
- Detailed debt activity; and
- Detailed investment activity.

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

The Council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or
- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

£m General Fund	2015/16 Actual £'000	2016/17 Working Estimate £'000	2016/17 Actual £'000
Capital expenditure	**3,524**	**9,431**	**5,686**
Financed in year	2,156	4,564	3,501
Unfinanced capital expenditure	**1,368**	**4,867**	**2,185**

2. The Council's Overall Borrowing Need

The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure 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 unfinanced capital expenditure (see above table), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies, (such as the Government, through the Public Works Loan Board [PWLB] or the money markets), or utilising temporary cash resources within the Council.

Reducing the CFR – the Council's underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council has a negative CFR so is not required to make an annual revenue charge, called the Minimum Revenue Provision – MRP, to reduce the CFR. MRP is effectively a repayment of the borrowing need. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

The total CFR can also be reduced by:

- the application of additional capital financing resources, (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

The Council's 2016/17 MRP Policy, (as required by CLG Guidance), was approved as part of the Treasury Management Strategy Report for 2016/17 on 11/02/2016. Because the Council is in the unusual position of having a negative CFR there is no requirement currently to make an annual revenue charge (MRP).

The Council's CFR for the year is shown below, and represents a key prudential indicator. It includes leasing schemes on the balance sheet, which increase the Council's borrowing need. No borrowing is actually required against these schemes as a borrowing facility is included in the contract (if applicable).

CFR (£m): General Fund	31 March 2016 Actual	31 March 2017 Actual
Opening balance	-20.122	-18,767
Add unfinanced capital expenditure (as above)	1.368	2.185
Less MRP/VRP	0	0
Less Finance Lease repayments	0.013	**0.013**
Closing balance	-18.767	**-16.60**

Borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit.

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2016/17) plus the estimates of any additional capital financing requirement for the current (2017/18) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs if required. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

	31 March 2016 Actual	31 March 2017 Budget	31 March 2017 Actual
Gross borrowing position	£1.515m	£0.480m	£0.480m
CFR	-£18.767m	-£15.738m	-£16.60m

The authorised limit - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level. The table below demonstrates that during 2016/17 the Council has maintained gross borrowing within its authorised limit.

The operational boundary – the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary is acceptable subject to the authorised limit not being breached.

Actual financing costs as a proportion of net revenue stream - this indicator identifies the trend in the cost of capital, (borrowing and other long term obligation costs net of investment income), against the net revenue stream.

	2016/17
Authorised limit	£7. 0m
Maximum gross borrowing position	£1.52m
Operational boundary	£5.0m
Average gross borrowing position	£1.1m
Financing costs as a proportion of net revenue stream	-2.2%

3. Treasury Position as at 31 March 2017

The Council's debt and investment position is organised by the treasury management service in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through member reporting detailed in the summary, and through officer activity detailed in the Council's Treasury Management Practices. At the end of 2016/17 the Council's treasury position was as follows:

TABLE 1	31 March 2016 Principal	Rate/ Return	31 March 2017 Principal	Rate/ Return
Fixed rate funding:				
-PWLB	£0.515m	9.21%	£0.480m	9.43%
-Market	£1.000m	10.125%	£0m	
Variable rate funding:				
-PWLB	£0m		£0m	
-Market	£0m		£0m	
Total debt	**£1.515m**	**8.55%**	**£0.480**	**9.43%**
CFR	**-£18.8m**		**-16.6m**	
Over / (under) borrowing	**£20.315m**		**£17.08m**	
Investments:				
- in house	£9.525m	0.62%	£7.5m	0.66%
- with managers	£28.5m	1.25%	£28.5m	1.15%
Total investments	**£38.025m**	**1.22%**	**£36.0m**	**1.12%**

The maturity structure of the debt portfolio was as follows:

	31 March 2016 actual	31 March 2017 actual
Under 12 months	£1.035m	£0.025m
12 months and within 24 months	£0.025m	£0.016m
24 months and within 5 years	£0.050m	£0.053m
5 years and within 10 years	£0.100m	£0.097m
10 years and above	£0.305m	£0.289m

The maturity structure of the investment portfolio was as follows:

	2015/16 Actual £000	2016/17 Original £000	31 March 2017 Actual £000
Investments			
Longer than 1 year	7,750	0	7,000
Under 1 year	30,275	23,500	29,000
Total	38,025	23,500	36,000

The exposure to fixed and variable rates was as follows:

	31 March 2016 Actual £000	2016/17 Original Limits £000	31 March 2017 Actual £000
Fixed rate (principal)	36,000Cr	70%-100% of Investments	29,500Cr
Variable rate (principal)	2,025Cr	0%-30% of Investments	6,500Cr

4. The Strategy for 2016/17

The strategy in 2016/17 was to continue only lending to UK banks, building societies and money market funds. Only UK banks with a credit rating, for longer term deals, greater than "BBB" and F3 or above for short term credit ratings were on the Council's lending list. (These are Fitch definitions of ratings). Not all building societies are credit rated but this did not preclude them from the lending list as lending to a building society was dependant on their asset size. Where a society did have a rating, this was considered at the time of the deal taking into account the amount of investment and the length of the deal. As well as imposing maximum limits with each counter party, the overall percentage of outstanding investments with each counterparty was assessed to ensure a reasonable spread of investments.

Change in strategy during the year – the strategy adopted in the original Treasury Management Strategy Report for 2016/17, approved by the Council on 11/02/2016, was not changed during the year.

5. The Economy and Interest Rates

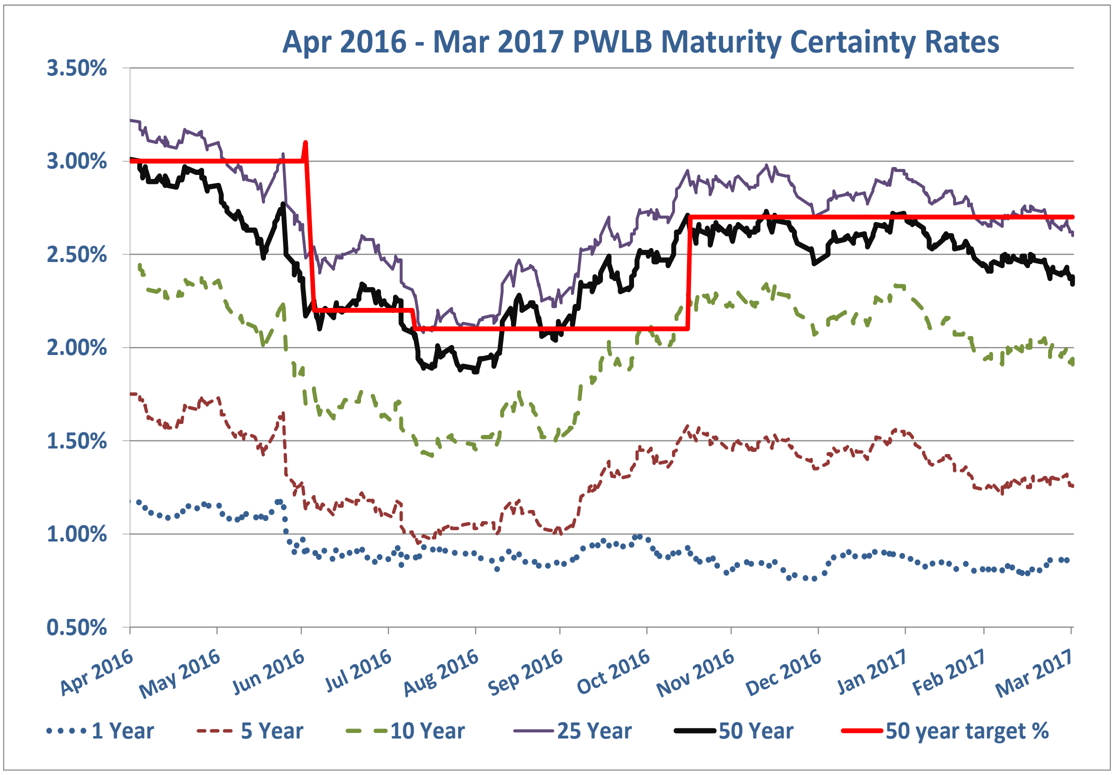
The two major landmark events that had a significant influence on financial markets in the 2016-17 financial year were the UK EU referendum on 23 June and the election of President Trump in the USA on 9 November. The first event had an immediate impact in terms of market expectations of when the first 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.

6. Borrowing Rates in 2016/17

PWLB certainty maturity borrowing rates

During 2016-17, PWLB rates fell from April to June and then gaining fresh downward impetus after the referendum and Bank Rate cut, before staging a partial recovery through to December and then falling slightly through to the end of March. The graph for PWLB rates below show, for a selection of maturity periods, the average borrowing rates, the high and low points in rates, spreads and individual rates at the start and the end of the financial year.



7. Borrowing Outturn for 2016/17

Borrowing

No new loans were taken during the year.

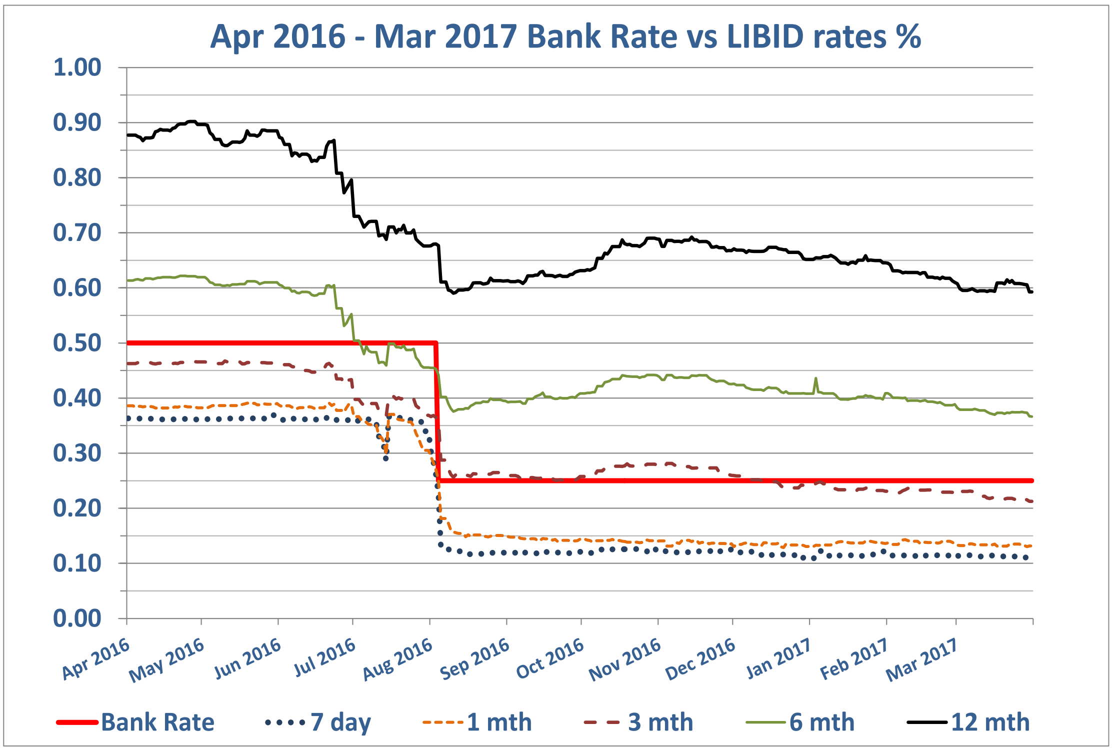
The £1M LOBO loans were repaid in November.
£35K of PWLB loans were repaid during the year

Rescheduling

No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

8. Investment Rates in 2016/17

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 quarter 3 2018, but then moved back to around the end of 2019 in early August before finishing the year back at quarter 3 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.



9. Investment Outturn for 2016/17

Investment Policy – the Council's investment policy is governed by CLG investment guidance, which has been implemented in the annual investment strategy approved by the Council on 11/02/16. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the Fitch credit rating agency for banks and asset size for building society investments.

The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties. However, there was one breach to "investing no more than 10% of outstanding investments with one counter party". An existing investment was renewed with The Royal Bank of Scotland on 13th March for £2.75M and although the total invested with them remained unchanged, this was slightly over the 10% limit.

Investments placed by Cash Managers – the Council used two external cash managers to invest its cash balances. At the start of the year, Sterling had £1m of outstanding investments, Tradition £27.5m. Sterling ended their contract in December 2014 and as their investments matured, Tradition reinvested the principal. At year end, there were no outstanding investments placed by Sterling and Tradition had £28.5m. The final Sterling investment of £1m matured in June and was reinvested by Tradition.

The performance of the managers against the benchmark return was:

Cash Manager	Investments Placed	Interest	Return	Benchmark*
Sterling	£1M - £0M	£0.003M	1.50%	N/A
Tradition	£27.5M - £28.5M	£0.331M	1.17%	0.25%
Total	£28.5M	£0.334M	1.17%	

* Ave 7 days notice Rate 0.25%

This compares with an original budget of £0.322M.

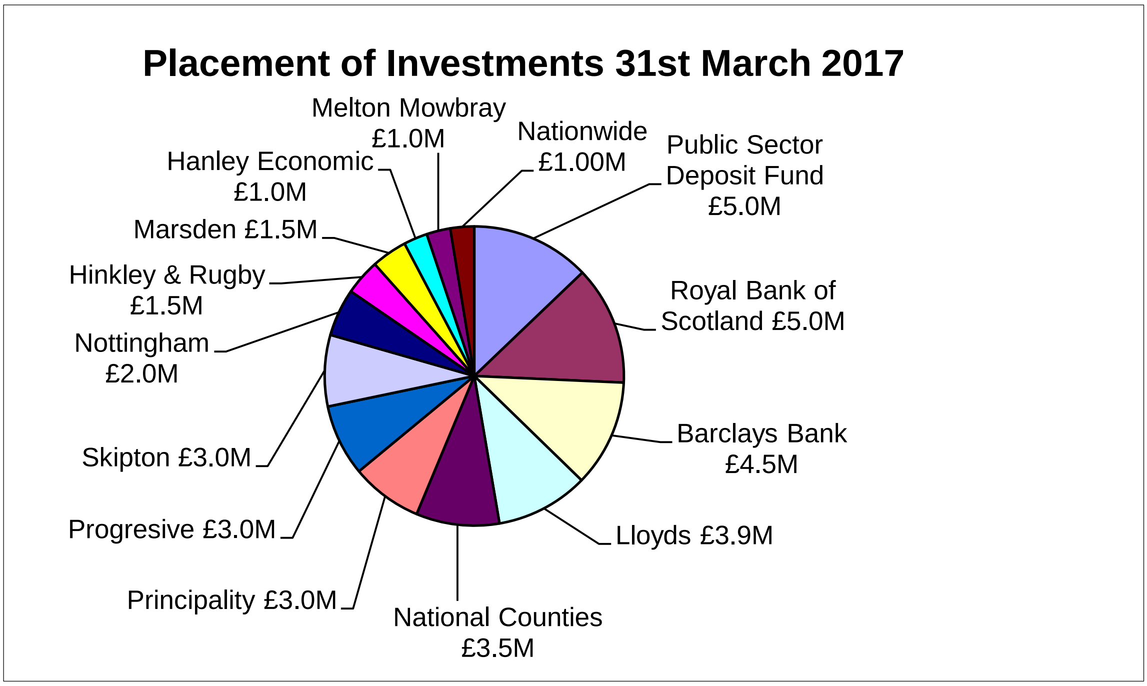
	Ave. Int. Rate Deals made in 1st Qtr %	Ave. Int. Rate Deals made in 2nd Qtr%	Ave. Int. Rate Deals made in 3rd Qtr %	Ave. Int. Rate Deals made in 4th Qtr %	Ave. Int. Rate Deals made in Year	Ave. Int. Rate for All Investments during Year %
NHDC	0.67	0.65	0.36	0.58	0.60	0.54
Sterling	n/a	n/a	n/a	n/a	n/a	1.50
Tradition	1.27	0.79	0.79	0.69	1.04	1.17

The NHDC figures above do not include interest rates achieved on the Lloyds current account. This started the year at 0.4% but reduced to 0.15% in August.

The table below summaries where investments were held at 31 March and includes the Lloyds Bank interest bearing current account:

	Investments 31 March 2015	Investments 31 March 2016
Banks	£14.90m	£13.40m
Building Societies	£21.50m	£20.50m
Local Authorities	£5.00m	-
Money Market Funds	£0.525m	£5.00m
Total	£41.925m	£38.90m

The pie chart below shows the spread of investment balances as at 31 March 2017. This is a snapshot in time that demonstrates the diversification of investments.



The average daily balance of investments was £51.1m with balances varying between £38.5m and £59.6m.

£0.444m of interest was generated from investments during the year. This is slightly more than the estimated interest of £0.440m.

	Average Balance £M	Interest Accrued to 31 March £	Interest Received by 31 March £	Total Interest for the Year £	Average Rate of Return %
NHDC	22.6	2,710	108,067	110,777	0.48
Sterling	0.2	0	3,000	3,000	1.50
Tradition	28.3	200,380	130,134	330,514	1.17
Total	51.1	203,090	242,120	444,291	0.86

Investments held by the Council - the Council maintained an average balance of £22.6m of internally managed funds. The internally managed funds earned £111k of interest with an average rate of return of 0.48%. These figures include interest earned on the Lloyds current account.

Investments held by Sterling - Sterling had one investment for £1M mature in June. This was re-invested by Tradition.

Investments held by Tradition – Tradition maintained an average balance of £28.3M managed funds. This generated £0.331M interest and earned an average rate of return of 1.17%.
The graph below shows the maturity profile of investments at 31st March 2017.