Audit Committee

31 July 2017

Treasury Management Outturn 2016/2017

Report of John Hewitt, Corporate Director of Resources

Purpose of the Report

1 To provide the Audit Committee with details of the Annual Treasury Management Review and final outturn on treasury management activities for 2016/17.

Background

2 The attached report presented to Cabinet on 12 July 2017 provides a detailed review of the final outturn position for Treasury Management.

Recommendation and reasons

3 Members are asked to note the 2016/17 final outturn position on Treasury Management.

Contact: Beverley White Tel: 03000 261900

Appendix 1: Implications

Finance –
There are no direct financial implications arising for the Council as a result of this report.

Staffing -

None

Risk -

None

Equality and Diversity -

None

Accommodation -

None

Crime and Disorder -

None

Human Rights -

None

Consultation -

None

Procurement -

None

Disability Discrimination Act -

None

Legal Implications -

None

Cabinet

12 July 2017

Treasury Management Outturn 2016/17

Report of Corporate Management Team
John Hewitt, Corporate Director of Resources
Councillor Alan Napier, Cabinet Portfolio Holder for Finance

Purpose of the Report

1 To provide information on the Treasury Management outturn position for the year ended 31 March 2017.

Background

2 Treasury Management is the management of the Council's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities, and the pursuit of optimum performance consistent with those risks. It is concerned with how the Council manages its cash resources and its scope covers borrowing, investment and hedging instruments and techniques.

3 The regulatory framework governing Treasury Management covers the Council's cash management, loans and investments activity and requires that the Council receives, comments upon and agrees regular Treasury Management review reports.

4 Risk is inherent in all treasury management activities and it is necessary to balance risk against return on investment.

5 In addition to meeting the regulatory framework, this report incorporates the needs of the 'Prudential Code', which can be regarded as being best operational practice, to ensure adequate monitoring of the Council's capital expenditure plans and prudential indicators (PIs). The Treasury Management Strategy and PIs for 2016/17 were agreed by the Council as part of the Medium Term Financial Plan 2016/17 to 2019/20 (MTFP6) on 24 February 2016, were revised in the Mid-Year Review Report on Treasury Management which was agreed by Council on 7 December 2016 and have subsequently been updated as part of the Medium Term Financial Plan 2017/18 to 2019/20 report (MTFP7), agreed by Council on 22 February 2017.

6 The report also supports the objective in the revised Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management and the Communities and Local Government Investment Guidance. These state that Members should receive reports and scrutinise the Treasury Management function as part of good governance and best practice.

7 During 2016/17 the minimum reporting requirements were that full Council should receive the following reports:

(a) annual Treasury Management Strategy in advance of the year (reported to Council on 24 February 2016);

(b) mid-year Treasury Management update report (reported to Council on 7 December 2016);

(c) annual review following the end of the year (this report).

8 This report provides a summary of the following:

(a) economic and interest rate review for 2016/17;

(b) capital expenditure and financing during the year;

(c) overall borrowing requirement;

(d) treasury position as at 31/3/17;

(e) investment strategy;

(f) investment outturn for the year.

Economic and Interest Rate Review 2016/17

9 The Council's Treasury Management advisers, Capita Asset Services, have provided their views on how changes to market expectations influenced the economy during 2016/17.

10 These views are detailed in Appendix 2.

Capital Expenditure and Financing

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

(a) financed immediately through the application of capital or revenue resources (capital receipts, capital grants or revenue contributions), which has no resultant impact on the Council's borrowing need, or

(b) if insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

12 Actual capital expenditure forms one of the required prudential indicators. The following table shows the actual capital expenditure in 2016/17 and how this was financed.

	2016/17 Actual £ million
Capital Expenditure	107.141
PFI and Finance Lease	2.968
Total capital expenditure	**110.109**
Resourced by:	
Capital receipts	7.649
Capital grants	47.150
Capital reserves and revenue	20.398
Unfinanced capital expenditure	**34.912**

Overall Borrowing Requirement

13 The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).

14 The CFR results from the capital activity of the Council and what resources have been 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.

15 Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the Corporate Director of Resources' treasury management team organises the Council's cash position to ensure sufficient cash is available to meet the capital plans and cash flow requirements.

16 This may be sourced through borrowing from external bodies (such as the Government, PWLB or money markets), or internal resources (e.g. use of reserves, working capital).

17 The Council's capital finance requirement (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 is required to make an annual revenue charge, called the Minimum Revenue Provision (MRP), to reduce the CFR. This is effectively a repayment of the borrowing need.

18 The Council's 2016/17 MRP Policy, as required by the Department of Communities and Local Government (CLG) guidance was approved as part of the Treasury Management Strategy Report for 2016/17 on 24 February 2016, then updated and reported to Council on 22 February 2017.

19 The Council's CFR for 2016/17, as agreed in February 2016, is shown in the following table, and represents one of the key prudential indicators.

CFR	Original Estimate	Actual at 31 Mar 17
	£ million	**£ million**
Opening balance	498.063	410.407
add unfinanced capital expenditure	84.587	34.913
add acquisition of share & loan capital	-	0.11
less MRP/ VRP	-18.618	-13.589
less loan repayments	-	-0.09
Closing balance	**564.032**	**431.751**

20 The borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit. In order to ensure that borrowing levels are prudent over the medium term the Council's external borrowing, net of investments, must only be for a capital purpose. This essentially means that the Council is not borrowing to support revenue expenditure.

21 The authorised limit is the "affordable borrowing limit" required by section 3 of the Local Government Act 2003. The Council does not have the power to borrow above this level.

22 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.

23 The table below demonstrates that during 2016/17 the Council has maintained gross borrowing within its authorised limit.

	2016/17 (original) £ million	2016/17 (revised) £ million
Authorised limit	552.000	520.000
Operational boundary	499.000	467.000
Maximum gross borrowing position		255.639
Average actual gross borrowing position		247.633

Treasury Position as at 31 March 2017

24 The Council's debt and investment position is organised to ensure adequate liquidity for revenue and capital activities, security for investments, and to manage risks within all treasury management activities.

25 The Treasury position for the Council during 2016/17 is shown in the table below:

	31.03.16	Rate/ Return	Average Life	31.03.17	Rate/ Return	Average Life
	£million	%	years	£million	%	years
Capital Financing Requirement (CFR)	410			432		
Total Debt	246	4.15		256	3.96	
(-) Under Borrowing	-164			-176		
Total Investments	195	0.87	0.41	175	0.52	0.23
Net Debt (total debt less total investments)	51			81		

26 New borrowing of £20 million was raised during 2016/17 for the purpose of financing capital expenditure. A loan of £10 million matured and was repaid in December 2016.

27 Debt rescheduling opportunities are very limited in the current economic climate, therefore no debt rescheduling has been undertaken this year.

28 The maturity structure of the debt portfolio as at 31 March 2017, in comparison to the limits set out in the Treasury Management Strategy was as follows:

	31.03.17 Actual	2016/17 upper limits	31.03.17 Actual
	£ million	%	%
Under 12 months	0.007	20	-
12 months and within 24 months	10.002	40	3.91
24 months and within 5 years	22.028	60	8.62
5 years and within 10 years	62.617	80	24.49
10 years and above	160.979	100	62.98
Total	**255.633**		

29 As shown in the table above, the Council's borrowing was maintained within the upper limits set out in the Treasury Management Strategy for 2016/17.

Investment Strategy 2016/17

30 The prime objective of the Council's Investment Strategy is to ensure prudent investment of surplus funds. The Council's investment priorities are therefore the security of capital, liquidity of investments and, within those objectives, to secure optimum performance in terms of interest earned. The Council has regard to the CLG Guidance and the CIPFA Treasury Management Code when making its investment decisions.

31 Therefore the primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration.

32 The investment strategy adopted in the original Annual Treasury Management Statement for 2016/17 was subject to the following revisions, which were approved by Council on 7 December 2016:

(a) an increase to the Treasury Management Indicator for the upper limit on variable interest rate exposure;

(b) an extension of the list of investment instruments categorised as as non-specified to enable the Council to invest in other entities locally;

(c) an increase to the monetary limit for equity shareholdings;

(d) to add property funds to the list of instruments in which the Council is authorised to invest.

33 The main reasons for the above revisions were to facilitate a more balanced approach to investing by diversifying the Council's investment portfolio, spreading the investment risk and maximising investment returns and allow for investments in businesses within County Durham in order to encourage regeneration and economic development in the area.

Investment Outturn for 2016/17

34 As at 31 March 2017 the Council held investments totalling £174.617 million. The following table provides a breakdown of these investments split by the type of financial institution, split by maturity period.

Financial Institution	0-3 months	3-6 months	6-12 months	Total
	£ million			
Banks rated AA-	5.382	-	-	5.382
Banks rated A		14.225	61.642	75.867
Building Societies	-	-	14.225	14.225
Central Government	0.948	-	-	0.948
Other Local Authorities	59.252	-	-	59.252
Money Market Funds	18.943	-	-	18.943
TOTAL	**84.525**	**14.225**	**75.867**	**174.617**
% of total	**48.4%**	**8.1%**	**43.5%**	

35 The actual investment return for investment income for 2016/17 was £5.749 million, which is £4.108 million higher than the original budget of £1.641 million. This is mainly due to the dividend of £2.64 million received from Newcastle International Airport during the year.

36 The following table details the Council's equity shareholdings as at 31 March.

Company	31.03.16	31.03.17
	£ million	£ million
Atom Bank	-	0.152
Chapter Homes	0.450	1.715
Forrest Park	1.000	1.000
Newcastle International Airport Ltd	10.558	10.558
Polyphotonix	0.300	0.300
Total	**12.308**	**13.725**

37 Dividend income received of £3.122 million was received during 2016/17. This is included in the investment income figure of £5.749 million.

Icelandic Deposits Update

38 Prior to Local Government Review, one former District Council had £7 million deposited across the Icelandic banks Glitnir Bank hf (£4 million), Landsbanki (£2 million) and Kaupthing Singer and Friedlander Ltd (£1 million), which all collapsed financially in October 2008. The County Council inherited this position in April 2009.

39 The only outstanding balance as at 31 March 2017 is in relation to the investment with Kaupthing Singer and Friedlander Ltd (KSF). All monies with KSF are currently subject to the respective administration and receivership processes. As at 31 March 2017 84.25% of the outstanding balance has been repaid to the Council; 86% to 86.5% recovery is ultimately anticipated.

Recommendations and Reasons

40 It is recommended that Cabinet note the treasury management outturn position for 2016/17 and agree to report to Full Council on 20 September 2017.

Background Papers

(a) 24 February 2016 – County Council - General Fund Medium Term Financial Plan, 2016/17 to 2019/20 and Revenue and Capital Budget 2016/17.

(b) 07 December 2016 – County Council - Mid-Year Report for the Period to 30 September 2016 on Treasury Management.

(c) 22 February 2017 – County Council - Medium Term Financial Plan, 2017/18 – 2019/20 and Revenue and Capital Budget 2017/18.

Contact: Jeff Garfoot Tel: 03000 261946

Appendix 1: Implications

Finance

The report details the Council's cash management, loans and investment activity during 2016/17. The report also provides the overall financing of the Council's capital expenditure, along with borrowing and investment income returns.

Staffing

None.

Risk

None.

Equality and Diversity / Public Sector Equality Duty

None.

Accommodation

None.

Crime and Disorder

None.

Human Rights

None.

Consultation

None.

Procurement

None.

Disability Issues

None.

Legal Implications

None.

Appendix 2: Economic and Interest Rate Review provided by Capita

Capita Asset Services, the Council's treasury adviser, has provided the following economic and interest rate review for 2016/17.

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.

USA. Quarterly growth in the US has been very volatile during 2016 but a strong performance since mid-2016, and strongly rising inflation, prompted the Fed into raising rates in December 2016 and March 2017. The US is the first major western country to start on a progressive upswing in rates. Overall growth in 2016 was 1.6%.

EU. The EU is furthest away from an upswing in rates; the European Central Bank (ECB) has cut rates into negative territory, provided huge tranches of cheap financing and been doing major quantitative easing purchases of debt during 2016-17 in order to boost growth from consistently weak levels, and to get inflation up from near zero towards its target of 2%. These purchases have resulted in depressed bond yields in the EU, but, towards the end of 2016, yields rose, probably due at least in part to rising political concerns around the positive prospects for populist parties and impending general elections in 2017 in the Netherlands, France and

Germany. The action taken by the ECB has resulted in economic growth improving significantly in the eurozone to an overall figure of 1.7% for 2016, with Germany achieving a rate of 1.9% as the fastest growing G7 country.

On the other hand, President Trump's election and promise of fiscal stimulus, which are likely to increase growth and inflationary pressures in the US, have resulted in Treasury yields rising sharply since his election. Gilt yields in the UK have been caught between these two influences and the result is that the gap in yield between US treasuries and UK gilts has widened sharply during 2016/17 due to market perceptions that the UK is still likely to be two years behind the US in starting on an upswing in rates despite a track record of four years of strong growth.

Japan struggled to stimulate consistent significant growth with GDP averaging only 1.0% in 2016 with current indications pointing to a similar figure for 2017. It is also struggling to get inflation up to its target of 2%, only achieving an average of -0.1% in 2016, despite huge monetary and fiscal stimulus, though this is currently expected to increase to around 1% in 2017. It is also making little progress on fundamental reform of the economy.

China and emerging market counties. At the start of 2016, there were considerable fears that China's economic growth could be heading towards a hard landing, which could then destabilise some emerging market countries particularly exposed to a Chinese economic slowdown and / or to the effects of a major reduction in revenue from low oil prices. These fears have largely subsided and oil prices have partially recovered so, overall, world growth prospects have improved during the year.

Equity markets. The result of the referendum, and the consequent devaluation of sterling, boosted the shares of many FTSE 100 companies which had major earnings which were not denominated in sterling. The overall trend since then has been steeply upwards and received further momentum after Donald Trump was elected President as he had promised a major fiscal stimulus to boost the US economy and growth rate.

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.

PWLB certainty maturity borrowing rates in 2016/17

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.