WARWICK DISTRICT COUNCIL	Finance and Audit Scrutiny Committee 27th June 2017.	Agenda Item No. 4

Title	2016/17 Annual Treasury Management Report
For further information about this report please contact	Karen Allison, Assistant Accountant 01926 456334 e mail: karen.allison@warwickdc.gov.uk
Wards of the District directly affected	None
Is the report private and confidential and not for publication by virtue of a paragraph of schedule 12A of the Local Government Act 1972, following the Local Government (Access to Information) (Variation) Order 2006	No
Date and meeting when issue was last considered and relevant minute number	N/A
Background Papers	Treasury Management Annual Strategy Plan 2016/2017 Various documents from Capita Asset Services - Treasury Solutions

Contrary to the policy framework:	No
Contrary to the budgetary framework:	No
Key Decision?	No
Included within the Forward Plan? (If yes include reference number)	No
Equality & Sustainability Impact Assessment Undertaken	No – not relevant

Officer/Councillor Approval

Officer Approval	**Date**	**Name**
Chief Executive	06/06/2017	Andrew Jones
Head of Service	N/A	
CMT	N/A	
Section 151 Officer	06.06.2017	Mike Snow
Monitoring Officer	N/A	
Finance	05.06.2017	Roger Wyton
Portfolio Holder(s)	07.06.2017	Peter Whiting

Consultation & Community Engagement

None

Final Decision?	Yes

Suggested next steps (if not final decision please set out below)
N/A

1. **Summary**

1.1. The Council is required to report upon its 2016/17 Treasury Management performance by 30th September. This report therefore details and reviews the Council's performance for the whole of 2016/17 and is attached as Appendix A.

1.2 Consideration of the Council's Treasury Management activities is within the remit of the Finance and Audit Scrutiny Committee hence, it is appropriate to report the Council's annual performance direct to this Committee.

1.3 The report follows the format used in the Treasury Management Strategy Plan presented to the Executive on 10th February 2016 and comments, where appropriate, on the Council's actual performance against what was forecast in the Strategy Plan. The Council also has to comment upon its performance against its Annual Investment Strategy for the year.

2. **Recommendations**

2.1 That the Members of the Finance and Audit Scrutiny Committee note the contents of this report in respect to this Council's 2016/17 Treasury Management activities.

3. **Reasons for the recommendations**

3.1 The 2016/17 Treasury Management Strategy and the Council's Treasury Management Practices, in accordance with the Code of Practice for Treasury Management, require that the Treasury Management function reports upon its activities during the year by no later than 30th September in the year after that which is being reported upon.

4. **Policy framework**

4.1 **Policy Framework -**The Treasury Management function enables the Council to achieve its objectives within the strategy and policies.

4.2 **Fit for the Future** – The Treasury Management function enables the Council to meet its vision of a great place to live work and visit as set out in the Sustainable Community Strategy. Treasury Management will support the Council in achieving its aims as set out in "Fit for the Future".

4.3 **Impact Assessments** – No impacts of new or significant policy changes proposed in respect of Equalities.

5. **Budgetary framework**

5.1 Treasury Management has a potentially significant impact on the Council's budgets through its ability to maximise its investment interest income and minimise borrowing interest payable. The Council is reliant upon interest received to help fund the services it provides. As detailed in paragraph 12.8, the gross interest to the Council was £510,000 against a Budget of £484,700, the net interest received by the General Fund for 2016/17 was £301,500 against a revised estimate of £297,400 and original of £342,000. The net interest received by the HRA for 2016/17 was £208,400 against a revised estimate of £187,300 and original of £195,500.

6. Risks

6.1 Investing the Council’s funds inevitably creates risk and the Treasury Management function effectively manages this risk through the application of the SLY principle. Security(S) ranks uppermost followed by Liquidity (L) and finally Yield(Y).

6.2 The Council invested in Corporate Bonds in 2016/17 which introduced Counterparty credit risk into the portfolio by virtue of the fact that it was possible that the institution invested in could have become bankrupt leading to the loss of all or part of the Council’s investment. This was mitigated by only investing in Corporate Bonds with a strong Fitch credit rating, in this case A and A+ and issued as Senior Unsecured debt which ranked above all other debt in the case of a bankruptcy. No such capital loss was incurred in 2016/17.

7 Alternative option considered

7.1 As explained in paragraph 3.1 the Code of Practice mandates that Annual Treasury Management Performance must be reported by 30th September after that financial year has closed.

7.2 The Council could consider varying its investment vehicles or Counterparty limits.

APPENDIX A

2016/17 ANNUAL TREASURY MANAGEMENT REPORT

1. Review of the interest rate environment.

1.1 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.

1.2 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.

2. Capital expenditure and financing

2.1 The Council's capital programme for 2016/17 amounted to £16,610,400 and was financed in the following manner:-

	2016/17 Actual		Strategy Report
	£		£
Loan/Internal Borrowing	2,758,700		50,000
Capital Receipts	4,304,500		504,200
Revenue and Reserves	8,157,300		10,665,500
External Contributions and Grants	1,389,900		498,900
Total	**16,610,400**		**11,718,600**

3. Borrowing

3.1 The Council managed its cash flow during the year such as to not require any temporary borrowing.

3.2 The Council incurred £4,765,564 interest on its external borrowing portfolio of £136.157 million in 2016/17 which was charged entirely to the HRA as it related to the Self Financing borrowing incurred in 2011/12.

3.3 Interest rates were such during the year that it precluded any opportunity for either the repayment or rescheduling of the PWLB debt.

4. Treasury limits and prudential indicators

4.1 The Prudential Capital Finance system was introduced on 1st April 2004. The system is regulated by a number of Prudential Indicators, a number of which are relevant for treasury management purposes and are included in the Annual Strategy Report. The table below shows the outturn against those quoted in the Strategy Report:-

	2016/17 Out-turn		2016/17 Strategy Report
	£		£
Authorised Limit for External Debt			
Borrowing	172,050,000		206,050,000
Other Long term Liabilities	2,078,700		1,045,000
Total	**174,128,700**		**207,095,000**
Operational Boundary for External Debt			
Borrowing	163,050,000		163,050,000
Other Long term Liabilities	1,078,700		45,000
Total	**164,128,700**		**151,095,000**
	2016/17 Out-turn		**2016/17 Strategy Report**
	£		**£**
Capital Financing Requirement			
General Fund	£1,615,716		-£949,510
Housing Revenue Account	£135,786,796		135,786,796

Overall	**£137,402,512**		**£134,837,286**
Incremental Impact on Council Tax / Housing Rents			
Council Tax	£0.36		£3.61
Housing Rent	£0.43		£0.45

The incremental impact on Council Tax and Housing Rents out-turn was lower than the expected figure due to slippage in the capital programme resulting in increased balances available for investment.

4.2 There are the following indicators relating to borrowing:-

Upper limit to fixed interest rate and variable interest rate exposures

Strategy Report - Upper Limit Fixed Rate = 100%
Actual – Upper Limit Fixed Rate = 100%

Strategy Report - Upper Limit Variable Rate = 30%
Actual – Upper Limit Variable Rate = 30%

Upper and lower limits respectively for the maturity structure of borrowing

Period	**Upper**	**Lower**
Under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%

In both cases the indicators were complied with as the only external borrowing outstanding at the year end was the £136.157m PWLB debt in respect of the HRA Self Financing Payment. This debt is all fixed rate maturing from years 41 to 50 of the Business Plan and therefore this is within both indicators shown above.

4.3 The final indicator monitors the amount invested for periods longer than 364 days which in 2016/17 was set at 70% of the investment portfolio subject to a maximum of £20 million at any one time. During 2016/17 the Council entered into two investments for 365 days or over, totalling £5m which confirms that the indicator was complied with.

5. Annual investment strategy and investment performance

5.1 The Government guidance on local government investments requires the production of an Annual Investment Strategy which amongst other things outlines the investment vehicles which could be used by the Council and separates them off into Specified and Non Specified investments. The 2016/17 Annual Investment Strategy was approved by the Council in February 2016.

5.2 The in house function has invested the Council's cash funds in fixed term Money Market deposits, Corporate Bonds, Certificates of Deposit (CD's) and Money Market Funds. The table below illustrates the performance for the year of the in house function for each category normally invested in (please refer to 2nd half year report for a breakdown by half year):-

(It should be noted that this table reflects investments placed in the year and does not take into account investments that were placed during 2015/16 which matured during 2016/17 and therefore the total interest for 2016/17 does not compare with that shown in paragraph 5.1 which is also net of the amount credited to the Housing Revenue Account in respect of interest earned on its balances).

Money Market Investments(includes Certificate of Deposits & Bonds):

Period	Investment Return (Annualised)	LIBID Benchmark (Annualised)	Out/(Under) performance
Up to 7 days			
Annual Performance	No investments made in year		
Over 7 days & Up to 3 Months			
Annual Performance	No investments made in year		
Over 3 Months & Up to 6 Months			
Annual Performance	0.73%	0.58%	+0.15%
Annual Interest	£9,876	£7,866	+£2,010
Over 6 Months to 364 days			
Annual Performance	0.80%	0.76%	+0.04%
Annual Interest	£278,238	£265,755	+£12,483
365 days and over			
Annual Performance	0.91%	0.86%	+0.05%
Annual Interest	£56,683	£53,490	+£3,193
Total Annual Interest – All categories.	**£344,797**	**£327,111**	**+£17,686**

5.3 Due to Money Market Funds outperforming the Up to 7 Day area of the Money Markets, this category was not used in 2016/17 .The two half years saw an out performance in all the periods where investments were made.

5.4 The in house function utilised the AAA rated Constant Net Asset Value (CNAV) Invesco AIM, Deutsche, Federated, Ignis and Goldman Sachs Money Market Funds and Variable Net Asset Value (VNAV) Federated and Royal London Asset Management Funds to assist in managing its short term liquidity needs. The table below illustrates the performance of all the funds for the full year:

Money Market Funds:

Fund	Investment Return (Annualised)	LIBID Benchmark (Annualised)	Out/(Under) Performance
Deutsche			
Annual Performance	0.29%	0.26%	+0.03%
Annual Interest	£8,616	£6,081	+£2,535
Goldman Sachs			
Annual Performance	0.28%	0.26%	+0.02%
Annual Interest	£4,773	£3,800	+£973
Invesco Aim			
Annual Performance	0.38%	0.26%	+0.12%
Annual Interest	£32,185	£21,577	+£10,608
Federated Prime Rate Constant Net Asset Value (CNAV)			
Annual Performance	0.44%	0.26%	+0.18%
Annual Interest	£22,260	£13,200	+£9,060
Federated Prime Rate Variable Net Asset Value (VNAV)			
Annual Performance	0.58%	0.41%	+0.17%
Annual Interest	£31,107	£22,115	+£8,992
Standard Life (was Ignis)			
Annual Performance	0.40%	0.26%	+0.13%
Annual Interest	£35,408	£23,366	+£12,042
Royal London Cash Plus Account (VNAV)			
Annual Performance	0.78%	0.52%	+0.26%
Annual Interest	£15,443	£10,497	+£4,946
TOTAL INTEREST FOR YEAR	**£149,792**	**£100,637**	**+£49,156**

5.5 The Up to 7 Days LIBID rate is the benchmark for the CNAV funds and it can be seen that they all made returns in excess of this. The two VNAV fund benchmarks are based on the 6 month LIBID rate (plus a margin of 0.0625%) and the returns include fees and so are not directly comparable with the benchmark.

5.6 The Council operates two Call accounts with HSBC and Svenska Handelsbanken. In the case of the HSBC account on balances of £2m+, until the base rate dropped to 0.25% in August 2016, this offered instant access at a rate more or less equivalent to our lower performing CNAV MMF's thus forming a useful addition for investing the Council's cash flow derived money.

However, the interest rate on this account is linked to the base rate and so reduced dramatically in August. Therefore the majority of the balance was migrated to the Goldman Sachs Money Market Fund to earn extra interest. The Svenska Handelsbanken account is a 35 day notice account currently offering 0.35% which compares favourably with the rate available in the Money Markets for 3 month fixed investments. Because of cash flow demands the HSBC Business Deposit Account underperformed against the LIBID benchmark rate but the Svenska Handelsbanken account compensated by comfortably outperforming the benchmark as can be seen in the table below:

Call Accounts:

Fund	Investment Return (Annualised)	LIBID Benchmark (Annualised)	Out/(Under) Performance
HSBC Business Deposit a/c			
Annual Performance	0.17%	0.26%	-0.09%
Annual Interest	£4,350	£6,144	-£1,794
Svenska Handelsbanken			
Annual Performance	0.49%	0.28%	+0.21%
Annual Interest	£16,954	£10,786	+£6,168
TOTAL INTEREST FOR YEAR	**£21,304**	**£16,931**	**+£4,374**

5.7 In paragraph 3.1 of the Annual Investment Strategy, the Council anticipated that it would have an average investment balance in the region of £57m during 2016/2017. The actual was £76.7m and the main differences are broken down below:-

General Fund Provision & Reserves	+£6,864,000
Major Repairs Allowance Reserve	+£1,544,000
Housing Capital investment Reserve	+£5,902,000

These increases are partly accounted for by slippage in the revenue and capital programmes leading to higher than expected balances in reserves, unused capital receipts and from increased cash flows during the year. As an illustration, the impact of the Housing Self-Financing regime has resulted in increased investment balances both of a cash flow nature and also as a result of the enhanced Capital Programme new build envisaged by the business plan not yet commencing. The investment strategy of this cash would not have been any different had the "additional" £19.7m balance being factored in. Paragraph 5.2 of the Annual Investment Strategy makes reference to a 70% maximum long term investments holding. The average investment balance in 2016/17 was £76.7m of which a maximum of £53.7m could have been invested for more than 364 days at any one time. In actual fact £3m was invested for more than 364 days which was 3.9% of the portfolio and therefore the Council did not exceed the 70% limit on longer term investments nor did it contravene the requirement to hold at least 40% of its portfolio in short term (364 days or less) investments. A comparison between 2015/16 actual, 2016/17 latest and 2016/17 actual in terms of in house investment interest returns and interest rates is shown in the table below:-

In House Investment Returns:

Year	Interest Received (£)	Interest Rate Achieved %
2015/16 actual	481,812	0.68
2016/17 latest	460,207	0.66
2016/17 actual	514,728	0.67

In the Annual Investment Strategy approved in February 2016, it was anticipated that the in house portfolio would achieve a 0.85% return for 2016/17. The actual rate was 0.67% which is close to the 2016/17 revised.

5.8 The table below compares the actual total interest received by the Council with what was expected when the original and latest estimates were calculated and also the 2015/16 actual:-

	Credited to General Fund	Credited to Housing Revenue Account	Total Investment Interest Earned
	£	£	£
2015/16 Actual	303,200	198,600	501,800
2016/17 Original	341,977	195,500	537,477
2016/17 Latest	272,907	187,300	460,207
2016/17 Actual	301,472	208,400	509,872

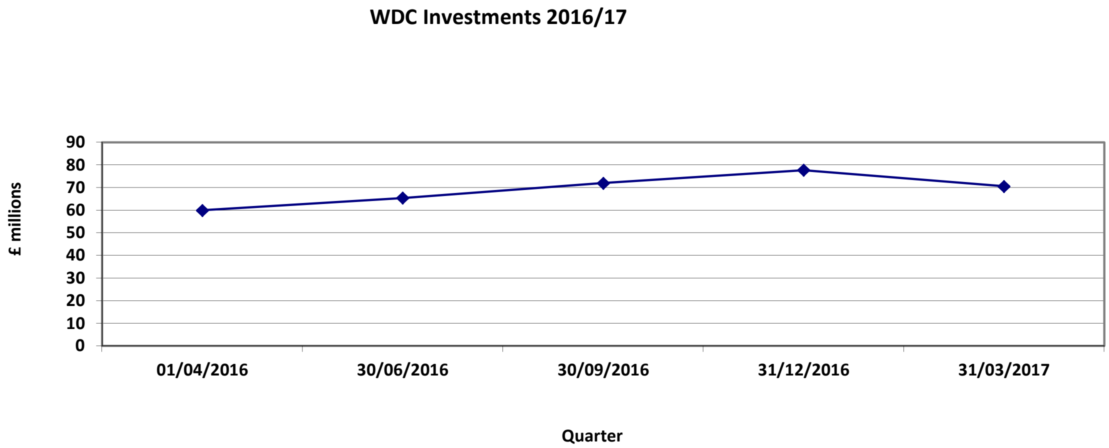
It should be borne in mind that the 2015/16 and 2016/17 actual figures in the tables in 5.7 and 5.8 are not directly comparable as the table in 5.7 relates only to investments made whilst the figures in 5.8 include interest received from other sources i.e. car loans, long term investments e.g. war stock and deferred capital receipts.

5.9 An analysis of the overall investments of the Council as at 31st March 2017 is shown in the table overleaf, with the previous year's figures shown for comparison purposes:

IN HOUSE	**31st March 2017**	**31st March 2016**
TYPE OF INVESTMENT	**£**	**£**
Money Markets inc. CD's & bonds	35,362,000	31,259,255
Call Accounts	4,047,000	5,046,000
Money Market Funds	31,125,000	23,679,000
Total	**70,534,000**	**59,998,255**

It should be noted that the Money Markets figure at 31st March 2017 includes £73,994 capital appreciation as a result of the price for each CD at 31st March being greater than that which was paid when the CD was originally purchased. However, these CD's were purchased on a "buy to hold" basis and thus this capital appreciation will not be realised when the CD's mature as they will be redeemed at "par" i.e. the original price.

5.10 The graph below shows how the total of the Council's investments varies through the year according to its cash flows. It illustrates that during the period April to December the Council's investments grows as cash flows in from such sources as Council Tax & NNDR and then from January onwards how the investments decline as cash flows out e.g. precepts exceed that coming in.



6. Performance measurement

6.1 In addition to the in house local benchmarks referred to in the tables in paragraphs 12.3, 12.5 and 12.8 the Council participates in the Capita Asset Services Investment Benchmarking Club which benchmarks not only investment returns but also the maturity and credit risk inherent in the portfolio. The Council is part of a local group which consists of District and County Councils and this Council's performance over the past year is reflected in the tables below:-

Table A Weighted Average Rate of Return (WARoR)

	WDC WARoR %	**Local Group WARoR %**	**Capita Asset Services Model WARoR %**
June Quarter	0.75	0.68	0.66
September Quarter	0.71	0.61	0.61
December Quarter	0.59	0.54	0.51
March Quarter	0.58	0.56	0.53
Average for Year	**0.66**	**0.60**	**0.58**

(n.b. it should be noted that the average interest rate for the year is not directly comparable to that quoted in paragraph 12.9 as that contains the effect of investments made in 2015/16 and maturing in 2016/17 whereas the rate in table A relates to 2016/17 investments only).

6.2 It can be seen that the Council's average return was above Capita Asset Services' model portfolio rate of return and also the local group's based on the risk in its portfolio.

Table B Weighted Average Credit Risk

	WDC	**Local Group**
June Quarter	3.2	3.1
September Quarter	3.2	2.9
December Quarter	3.1	3.1
March Quarter	3.1	3.1
Average for Year	**3.1**	**3.1**

6.3 This benchmark measures the average credit risk in the portfolio according to the institutions invested in and corresponds to the duration limits in Capita Asset Services' suggested credit methodology using a sliding scale of 1 to 7 where 1 indicates the least risk of default. The above table shows that this Council's credit risk during the year matched that of the local group.

7. <u>External treasury management advisers</u>

7.1 Capita Asset Services continues to provide our Treasury Management Advisory service.