WARWICK DISTRICT COUNCIL	Finance and Audit Scrutiny Committee 24th July 2018.	Agenda Item No. **4**

Title	2017/18 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Is the report private and confidential and not for publication by virtue of a paragraph of schedule 12A of the Local Government Act 1972, following the Local Government (Access to Information) (Variation) Order 2006	No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 Information via External Advisers, Brokers, External Investment Agents etc.

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	13/07/2018	Andrew Jones
Head of Service	13/07/2018	Mike Snow
CMT	13/07/2018	
Section 151 Officer	12/07/2018	Mike Snow
Monitoring Officer	13/07/2018	Andrew Jones
Finance	13/07/2018	Karen Allison & Jenny Clayton
Portfolio Holder(s)	13/07/2018	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 2017/18 Treasury Management performance by 30th September. This report therefore details and reviews the Council's performance for the whole of 2017/18 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 8th February 2017 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 2017/18 Treasury Management activities.

3. **Reasons for the recommendations**

3.1 The 2017/18 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 **Fit for the Future (FFF)**

The Council's FFF Strategy is designed to deliver the Vision for the District of making it a Great Place to Live, Work and Visit. To that end amongst other things the FFF Strategy contains several Key projects. This report shows the way forward for implementing a significant part of one of the Council's Key projects.

The FFF Strategy has 3 strands – People, Services and Money and each has an external and internal element to it. The table below illustrates the impact of this proposal if any in relation to the Council's FFF Strategy."

FFF Strands		
People	**Services**	**Money**
External		

Health, Homes, Communities	**Green, Clean, Safe**	**Infrastructure, Enterprise, Employment**
Intended outcomes: Improved health for all Housing needs for all met Impressive cultural and sports activities Cohesive and active communities	Intended outcomes: Area has well looked after public spaces All communities have access to decent open space Improved air quality Low levels of crime and ASB	Intended outcomes: Dynamic and diverse local economy Vibrant town centres Improved performance/ productivity of local economy Increased employment and income levels
Impacts of Proposal		
The Treasury Management function enables the Council to meet its vision.	The Treasury Management function enables the Council to meet its vision.	The Treasury Management function enables the Council to meet its vision.
Internal		
Effective Staff	**Maintain or Improve Services**	**Firm Financial Footing over the Longer Term**
Intended outcomes: All staff are properly trained All staff have the appropriate tools All staff are engaged, empowered and supported The right people are in the right job with the right skills and right behaviours	Intended outcomes: Focusing on our customers' needs Continuously improve our processes Increase the digital provision of services	Intended outcomes: Better return/use of our assets Full Cost accounting Continued cost management Maximise income earning opportunities Seek best value for money
Impacts of Proposal		
The Treasury Management function enables the Council to meet its vision.	The Treasury Management function enables the Council to meet its vision.	The Treasury Management function enables the Council to meet its vision.

4.2 **Supporting Strategies**

Each strand of the FFF Strategy has several supporting strategies. The Treasury Management function is consistent with the relevant supporting strategies.

4.3 **Changes to Existing Policies**

The Treasury Management function is in accordance with existing policies.

4.4 **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 Appendix A paragraph 5.8, the gross interest to the Council was £388,800 against a Budget of £513,400 (Revised), the net interest received by the General Fund for 2017/18 was £217,700 against a revised estimate of £287,600 and original of £235,500. The net interest received by the HRA for 2017/18 was £171,100 against a revised estimate of £225,800 and original of £177,800. The reasons for the shortfall against that budgeted are discussed in the Final Accounts Report to Executive, and the Treasury Management half year report also on this agenda.

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 In addition to credit ratings themselves, the Council will also have regard to any ratings watch notices issued by the 3 agencies as well as articles in the Financial press, market data and intelligence from Capita benchmarking groups. It will also use Credit Default Swap (CDS) data as supplied by Capita Asset Services – Treasury Solutions to determine the suitability of investing with counterparties.

6.3 Corporate Bonds and Floating Rate Notes (FRN's) introduce Counterparty credit risk into the portfolio by virtue of the fact that it is possible that the institution invested in could become bankrupt leading to the loss of all or part of the Council's investment. This is mitigated by only investing in Corporate Bonds or FRN's with a strong Fitch credit rating, in this case A and issued as Senior Unsecured debt which ranks above all other debt in the case of a bankruptcy.

6.4 Covered Bonds also reduces risk as the bond is "backed" by high quality assets such as prime residential mortgages thus ensuring that if the bond issuer defaults there are sufficient assets that can be realised in order to repay the bond in full.

6.5 While Corporate Equity Funds can help to ensure capital security in real (as opposed to nominal) terms, they consequently introduce the risk of capital loss due to market price fluctuations. As part of the February 2018 Budget Report, the Council set up an Investment Rate Volatility Reserve, transferring £100,000 into it during 2017/18 to mitigate against any adverse losses.

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

2017/18 ANNUAL TREASURY MANAGEMENT REPORT

1. Review of the interest rate environment.

i. The major UK landmark event of the year was the inconclusive result of the general election on 8 June. However, this had relatively little impact on financial markets. Sterling did suffer a sharp devaluation against most other currencies, although it has recovered about half of that fall since then. Brexit negotiations have been a focus of much attention and concern during the year but so far, there has been little significant hold up to making progress.

ii. During the calendar year of 2017, there was a major shift in expectations in financial markets in terms of how soon Bank Rate would start on a rising trend. After the UK economy surprised on the upside with strong growth in the second half of 2016, growth in 2017 was disappointingly weak in the first half of the year which meant that growth was the slowest for the first half of any year since 2012. The main reason for this was the sharp increase in inflation caused by the devaluation of sterling after the EU referendum, feeding increases into the cost of imports into the economy. This caused a reduction in consumer disposable income and spending power as inflation exceeded average wage increases. Consequently, the services sector of the economy, accounting for around 75% of GDP, saw weak growth as consumers responded by cutting back on their expenditure.

iii. Growth did pick up modestly in the second half of 2017. Consequently, market expectations during the autumn, rose significantly that the MPC would be heading in the direction of imminently raising Bank Rate. The minutes of the MPC meeting of 14 September indicated that the MPC was likely to raise Bank Rate very soon. The 2 November MPC quarterly Inflation Report meeting duly delivered by raising Bank Rate from 0.25% to 0.50%.
The 8 February MPC meeting minutes then revealed another sharp hardening in MPC warnings on a more imminent and faster pace of increases in Bank Rate than had previously been expected.
Market expectations for increases in Bank Rate, therefore, shifted considerably during the second half of 2017-18 and resulted in investment rates from 3 – 12 months increasing sharply during the spring quarter.

iv. PWLB borrowing rates increased correspondingly to the above developments with the shorter term rates increasing more sharply than longer term rates. In addition, UK gilts have moved in a relatively narrow band this year, (within 25 bps for much of the year), compared to US treasuries. During the second half of the year, there was a noticeable trend in treasury yields being on a rising trend with the Fed raising rates by 0.25% in June, December and March, making six increases in all from the floor. The effect of these three increases was greater in shorter terms around 5 year, rather than longer term yields.

v. As for equity markets, the FTSE 100 hit a new peak near to 7,800 in early

January before there was a sharp selloff in a number of stages during the spring, replicating similar developments in US equity markets

2. Capital expenditure and financing

2.1 The Council's capital programme for 2017/18 amounted to £15,397,400 and was financed in the following manner:-

	2017/18 Actual		Strategy Report
	£		£
Prudential/Internal Borrowing	6,923,400		8,996,000
Capital Receipts	1,301,800		1,012,400
Revenue	4,476,600		125,206
Reserve Contributions			5,890,900
External Contributions and Grants	2,695,600		2,626,100
Total	**15,397,400**		**18,856,300**

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 £4,713,339 interest on its external borrowing portfolio of £136.157 million in 2017/18 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:-

	2017/18 Out-turn		2017/18 Strategy Report
	£		**£**
Authorised Limit for External Debt			
Borrowing	194,050,000		206,050,000
Other Long term Liabilities	2,063,000		2,063,000
Total	**196,113,000**		**208,113,000**
Operational Boundary for External Debt			
Borrowing	151,050,000		163,050,000
Other Long term Liabilities	1,063,000		1,063,000
Total	**152,113,000**		**164,113,000**
	2017/18 Out-turn		**2017/18 Strategy Report**
	£		**£**
Capital Financing Requirement			
General Fund	£9,902,415		11,248,319
Housing Revenue Account	£135,786,796		135,786,796
Overall	**£145,689,211**		**147,035,115**
Incremental Impact on Council Tax / Housing Rents			
Council Tax	£6.51		£7.40
Housing Rent	£0.28		£0.28

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

Strategy 2017/18	Fixed		Variable	
Period	**Upper**	**Lower**	**Upper**	**Lower**
Under 12 months	4%	0%	100%	0%
12 months and within 24 months	20%	0%	100%	0%
24 months and within 5 years	20%	0%	100%	0%
5 years and within 10 years	20%	0%	100%	0%
10 years and above	96%	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 2017/18 was set at 70% of the investment portfolio subject to a maximum of £20 million at any one time. During 2017/18 the Council entered into three investments for 365 days or over, totalling £8m 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 2017/18 Annual Investment Strategy was approved by the Council in February 2017.

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), Equity Funds 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 2016/17 which matured during 2017/18 and therefore the total interest for 2017/18 does not compare with that shown in paragraph 5.1 within the Budget Framework 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	0.80%	0.46%	+0.34%
Annual Interest	£2,038	£1,163	+£875
Over 3 Months & Up to 6 Months			
Annual Performance	0.70%	0.53%	+0.17%
Annual Interest	£16,452	£12,649	+£3,803
Over 6 Months to 364 days			
Annual Performance	0.73%	0.70%	+0.03%
Annual Interest	£197,233	£187,155	+£10,078
365 days and over			
Annual Performance	0.84%	0.62%	+0.22%
Annual Interest	£21,122	£15,691	+£5,431
Total Annual Interest – All categories.	**£236,846**	**£216,658**	**+£20,187**

5.3 Due to Money Market Funds outperforming the Up to 7 Day area of the Money Markets, this category was not used in 2017/18 .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, Deutsche, Federated, Standard Life 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	0.20%	0.28%	-0.08%
Annual Interest	£5,366	£7,509	-£2,143
Goldman Sachs			
Annual Performance	0.27%	0.28%	-0.01%
Annual Interest	£7,422	£8,583	-£1,161
Invesco			
Annual Performance	0.28%	0.28%	0.00%
Annual Interest	£24,855	£24,550	£305
Standard Life			
Annual Performance	0.30%	0.28%	0.02%
Annual Interest	£26,273	£24,775	£1,498
Federated Constant Net Asset Value (CNAV)			
Annual Performance	0.34%	0.28%	0.06%
Annual Interest	£17,232	£13,880	£3,352
Federated Variable Net Asset Value (VNAV)			
Annual Performance	0.40%	0.37%	0.03%
Annual Interest	£23,341	£16,244	£7,097
Royal London Cash Plus Account (VNAV)			
Annual Performance	0.34%	0.29%	0.05%
Annual Interest	£17,772	£14,950	£2,822
TOTAL INTEREST FOR YEAR	**£122,261**	**£110,491**	**£11,770**

5.5 The Up to 7 Days LIBID rate is the benchmark for the CNAV funds and the Cash Plus fund and it can be seen that they all made returns in excess of this. The VNAV fund benchmark is 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+ this offered instant access at a rate above our lower performing CNAV MMF’s thus forming a useful addition for investing the Council’s cash flow derived money.The Svenska Handelsbanken account is a 35 day notice account which offered an increase from 0.35% to 0.45% in January 2018 which compares favourably with the rate available in the Money Markets for 3 month fixed investments. The HSBC Business Deposit Account and the Svenska Handelsbanken account outperformed 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 Account			
Rate for year	0.40%	0.27%	0.13%
Value of Interest earned in Year	£8,338	£7,689	£649
Svenska Handelsbanken Account			
Rate for year	0.37%	0.30%	0.07%
Value of Interest earned in Year	£16,568	£13,355	£3,213
TOTAL INTEREST FOR YEAR £	**£24,906**	**£21,044**	**£3,862**

5.7 In paragraph 2.3 of the Annual Investment Strategy, the Council anticipated that it would have an average investment balance in the region of £75m during 2017/2018. The actual was £84.8m and the main differences are broken down below:-

General Fund Provision & Reserves	+£1,190,500
Major Repairs Allowance Reserve	+£2,230,200
Housing Capital investment Reserve	+£6,379,300

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 of a cash flow nature. The investment strategy of this cash would not have been any different had the “additional” £9.8m balance being factored in to the projections. Paragraph 5.5 of the Annual Investment Strategy makes reference to a 70% maximum long term investments holding. The average investment balance in 2017/18 was £84.8m of which a maximum of £59.4m could have been invested for more than 364 days at any one time. In actual fact £2m was invested for more than 364 days which was 2.4% of the portfolio. This was in anticipation of the long term interest rate rising. 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 2016/17 actual, 2017/18 latest and 2017/18 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 %
2016/17 actual	514,728	0.67
2017/18 latest	513,400	0.73
2017/18 actual	389,491	0.64

In the Annual Investment Strategy approved in February 2017, it was anticipated that the in house portfolio would achieve a 0.57% return for 2017/18. The actual rate was 0.64%.

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 2016/17 actual:-

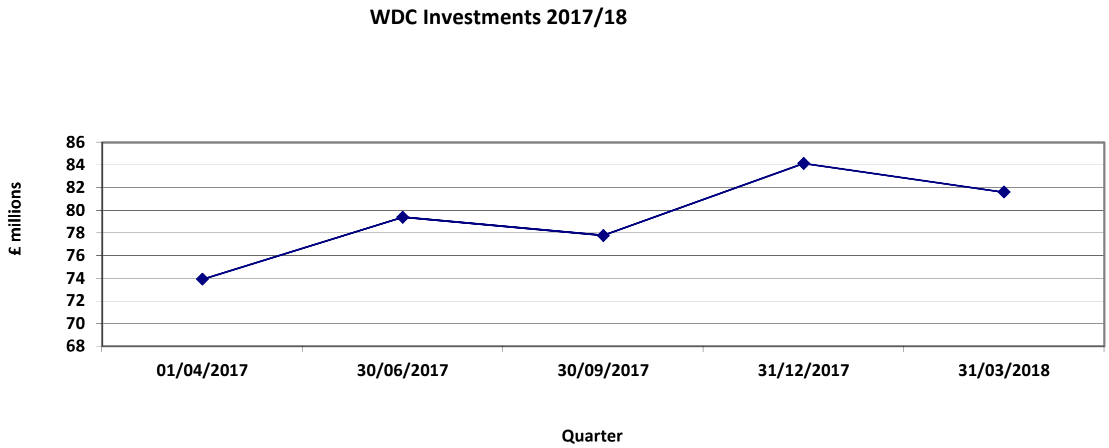
	Credited to General Fund	Credited to Housing Revenue Account	Total Investment Interest Earned
	£	£	£
2016/17 Actual	301,472	208,400	509,872
2017/18 Original	235,525	177,800	413,325
2017/18 Latest	287,629	225,816	513,445
2017/18 Actual	217,710	171,057	388,767

5.9 An analysis of the overall investments of the Council as at 31st March 2018 is shown in the table below, with the previous year's figures shown for comparison purposes:

IN HOUSE	31st March 2018	31st March 2017
Type of Investment	**£**	**£**
Money Markets incl. CD's & Bonds	46,745,000	35,362,000
Money Market Funds	23,000,000	31,125,000
Business Reserve Accounts incl. Call Accounts	6,055,000	4,047,000
Total In House Investments	**75,800,000**	**70,534,000**

It should be noted that the Money Markets figure at 31st March 2018 includes £5,652 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 grow 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. Equity Funds

6.1 On 13th April 2017 a £3 million investment was made with Columbia Threadneedle in a UK Equity Income Fund. Since inception it has produced three dividends in 2017/18 totalling £99,100.84 which were then used to buy more shares (this is the nature of the fund).

6.2 On 4th April 2017 a £3 million investment was made with Royal London Asset Management in a UK Equity Income Fund. Since inception it has produced three dividends in 2017/18 totalling £94,108.26 which were accumulated back into the fund as capital growth.

6.3 The total value of both funds at 31st March 2018 was £5,895,248.

6.4 At the time of writing this report the Royal London Fund had a value of £3.328m, the equivalent of a 40% annualised return since 31 March 2018. In comparison, the Columbia Threadneedle Equity Fund had a value of £3.227m, the equivalent of annualised growth of 48.7%. The total value of both funds at 10th July 2018 is £6,555,000.

6.5 The inclusion of equity funds in the Council's Investment Strategy was on the basis that these funds should be held for a number of years. History has shown that these funds may present volatile returns over the short term, but in the long term prove to provide returns greater than many other investment instrument. In addition, they are perceived to be less risky and more liquid that other investments, eg. property funds. Whilst the funds values at the 31 March were below the nominal value invested in April 2017, this can be attributed to the reduced Stock Exchange prices at that time. Since then, the values of the funds have increased substantially as shown by the above figures.

7. Performance measurement

7.1 In addition to the in house local benchmarks referred to in the tables in paragraphs 5.2, 5.4 and 5.6 the Council participates in the Link Group 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 %	LinkAsset Services Model WARoR %
June Quarter	0.53	0.47	0.46
September Quarter	0.52	0.41	0.45
December Quarter	0.55	0.51	0.52
March Quarter	0.56	0.55	0.56
Average for Year	**0.54**	**0.49**	**0.50**

(n.b. it should be noted that the average interest rate for the year is not directly comparable to that quoted in paragraph 5.7 as that contains the effect of investments made in 2016/17 and maturing in 2017/18 whereas the rate in table A relates to 2017/18 investments only).

7.2 It can be seen that the Council's average return was above Link Group's' 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	3.0	2.9
September Quarter	3.0	2.8
December Quarter	2.9	2.65
March Quarter	2.8	2.6
Average for Year	**2.9**	**2.7**

7.3 This benchmark measures the average credit risk in the portfolio according to the institutions invested in and corresponds to the duration limits in Link Group's 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 was only marginally above that of the local group.

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

8.1 Link Group (previously called Capita Asset Services) continues to provide our Treasury Management Advisory service.