Executive 29 June 2017

Report of the Director of Customer and Corporate Services
Portfolio of the Leader of the Council

Treasury management annual report and review of prudential indicators 2016/17

Summary

1. The 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).

2. The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by Members.

3. This report also confirms that the Council has complied with the requirement under the Code to give prior scrutiny to treasury management reports by Audit & Governance Committee.

Recommendations

4. The Executive is asked to:

   1) Note the 2016/17 performance of treasury management activity and prudential indicators outlined in annex A.

      Reason: to ensure the continued performance of the treasury management function can be monitored and to comply with statutory requirements.

Background and analysis

The Economy and Interest Rates

5. The two major landmark events that had a significant influence on financial markets during 2016/17 were the UK EU referendum on 23rd June and the election of President Trump in the USA on 9th 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 4th 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.

6. 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 1.8%, which was very nearly the fastest rate of growth of any of the G7 countries. 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.

Overall treasury position as at 31 March 2017

7. The Council's year end treasury debt and investment position for 2016/17 compared to 2015/16 is summarised in the table below:

Debt	31/03/2017 £m	Rate %	31/03/2016 £m	Rate %
General Fund debt	122.3	4.23	126.7	4.20
Housing Revenue Account (HRA) debt	139.0	3.34	140.3	3.34
Total debt	261.3	3.76	267.1	3.75
Investments				
Councils investment balance	91.6	0.49	77.2	0.56

Table 1 summary of year end treasury position as at 31 March 2017

The Strategy for 2016/17

8. The expectation for interest rates within the treasury management strategy for 2016/17 anticipated low but rising Bank Rate and gradual rises in medium and longer term fixed borrowing rates during 2016/17. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period. Continued uncertainty in the aftermath of the 2008 financial crisis promoted a cautious approach, whereby investments would continue to be dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

9. In this scenario, the treasury strategy was to postpone borrowing to avoid the cost of holding higher levels of investments and to reduce counterparty risk.

10. During 2016/17 there was major volatility in PWLB rates with rates falling during quarters 1 and 2 to reach historically very low levels in July and August, before rising significantly during quarter 3, and then partially easing back towards the end of the year.

Borrowing requirement and debt

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

	31 March 2017 Actual £m	31 March 2017 Budget £m	31 March 2016 Actual £m
CFR General Fund	183.9	205.0	179.1
CFR HRA	139.0	140.3	140.3
Total CFR	322.9	345.3	319.4

Table 2 capital financing requirement

Borrowing outturn for 2016/17

12. The Council continues to make efficient use of its strong cash balance position to support its current capital expenditure requirements. One new loan was taken during the year. This was a ten year fixed rate loan for £1,221,500 on 23rd March 2017 from West Yorkshire Combined Authority at 0% interest, repayable on the 28th February 2027. No repayments are due during the term of the loan. The purpose of the loan is to help to fund York Central infrastructure projects. Members are reminded that this is the first instalment of a total £2.55m loan agreed by Executive on the 14th July 2016.

13. As outlined in the mid year review report, two PWLB loans totalling £7m were repaid during the year. On 10th August 2016 a £5m PWLB loan was repaid which had an interest rate of 2.5% and on 5th November 2016 a £2m PWLB loan was repaid which had an interest rate of 3.6%, taking the Councils long-term borrowing figure to £261.3m. The weighted average interest rate for the repaid loans was 2.5%.

14. The HRA CFR has reduced from the previous year due to the appropriation of shops from the HRA to the General Fund as outlined in the 2016/17 financial strategy agreed by Full Council on the 25th February 2016.

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

<u>Investment rates in 2016/17</u>

16. As outlined in paragraph 5, the Bank Rate has remained at 0.25% since August 2016. 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 4th 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.

<u>Investment outturn for 2016/17</u>

17. The Council's investment policy is governed by CLG guidance, which has been implemented in the annual investment strategy approved by the Council on 25th February 2016. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data, (such as rating outlooks, credit default swaps, bank share prices etc.). The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

18. The Council maintained an average investment balance of £108.55m compared to £104.57m in 2015/16. The surplus funds earned an average rate of return of 0.49% in 2016/17 compared to 0.555% in 2015/16. There has been a gradual increase in cash balances over recent years to due the level of developer's contributions held pending investment through the capital programme, along with the continued early receipt of grant funding from Government in advance of spending. These balances are therefore not available in the longer term and will start to decrease as capital investment is made in a range of projects, as outlined in the Capital Strategy approved by Council in February 2017.

19. The comparable performance indicator for the Councils investment performance is the average London Inter Bank Bid Rate (LIBID) which represents the average interest rate at which major London banks borrow from other banks. Table 3 shows the rates for financial year 2016/17 and shows that for all cash holdings the rate of return exceeds the levels of the usual 7 day and 3 month benchmarks.

Benchmark	Benchmark Return	Council Performance
7 day	0.20	0.49
3 month	0.32	0.49

Table 3 – LIBID vs. CYC comparison

20. This compares with a budget assumption of average investment balances between a low point of £32m and high point of £112m at an average 0.6% investment return.

Consultation

21. The report has been reviewed and scrutinised by Audit and Governance Committee on 21st June 2017.

Options

22. Not applicable.

Council Plan

23. Effective treasury management ensures the Council has sufficient liquidity to operate, safeguards investments, maximises return on those investments and minimises the cost of debt. This allows more resources to be allocated for delivering the Council's priorities as set out in the Council Plan.

Implications

24. This report has the following implications:

- **Financial** are contained throughout the main body of the report.
- **Human Resources (HR)** There are no HR implications.
- **One Planet Council / Equalities** There are no One Planet Council or equalities implications.

- **Legal** Treasury management activities have to conform to the Local Government Act 2003, which specifies that the Council is required to adopt the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice.
- **Crime and Disorder** There are no crime and disorder implications.
- **Information Technology (IT)** There are no IT implications.
- **Property** There are no property implications.
- **Other** There are no other implications.

Risk Management

25. The treasury function is a high-risk area due to the large value transactions that take place. As a result, there are strict procedures set out as part of the treasury management practices statement. The scrutiny of this and other monitoring reports is carried out by Audit and Governance Committee as part of the Council's system of internal control.

Contact Details

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Sarah Kirby Principal Accountant	**Report Approved** ✓ **Date** 30/5/17

Wards Affected: List wards or tick box to indicate all **All** ✓

For further information please contact the author of the report

Background Papers:
None

Annexes:
Annex A: Prudential Indicators 2016/17

List of Abbreviations Used in this Report

CIPFA - Chartered Institute of Public Finance & Accountancy
MRP - Minimum Revenue Provision
CFR - Capital Financing Requirement
MPC - Monetary Policy Committee
PWLB - Public Works Loan Board
CLG – (Department for) Communities and Local Government
LIBID – The London Interbank Bid Rate