Report to: Audit Committee

Date of Meeting: 21 September 2017

Report Title: Annual Treasury Management Report 2016/17

Report By: Peter Grace
Assistant Director, Financial Services and Revenues

Purpose of Report

This report provides the opportunity for the Committee to scrutinise the Treasury Management activities and performance of the last financial year.

Recommendation(s)

1. To consider the report – no recommendations are being made to amend the current Treasury Management Strategy as a result of this particular review.

Reasons for Recommendations

To ensure that members are fully aware of the activities undertaken in the last financial year, that Codes of Practice have been complied with and that the Council's strategy has been effective in 2016-17.

Under the Code adopted the Full Council are required to consider the report and any recommendations made.

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Introduction

1. 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).

2. The primary requirements of the Code are as follows:

   a) Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

   b) Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.

   c) Receipt by the Full Council of an annual treasury management strategy report (including the annual investment strategy report for the year ahead, a mid-year review report (as a minimum) and an annual review report of the previous year.

   d) Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

   e) Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body which in this Council is the Audit Committee.

3. Treasury management in this context is defined as:

   "The management of the local authority'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."

4. 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.

5. Member training on treasury management issues was undertaken during the year on 10/1/2017 in order to support members' scrutiny role.

6. This annual Treasury report covers

   a) capital expenditure and financing 2016-17

   b) overall borrowing need (the Capital Financing Requirement)

   c) treasury position as at 31 March 2017;

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d) performance for 2016-17;

e) the strategy for 2016-17;

f) the economy and interest rates in 2016-17;

g) borrowing rates in 2016-17;

h) the borrowing outturn for 2016-17;

i) debt rescheduling;

j) compliance with treasury limits and Prudential Indicators;

k) investment rates in 2016-17;

l) investment outturn for 2016-17;

Capital Expenditure and Financing 2016/17

7. 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.

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

Capital Programme Financing 2016/17	Outturn 2016-17	
	£000's	£000's
Expenditure :		16,896
Borrowing		13,225
Grants:		
Disabled Facilities Grant	966	
Lottery Grants	180	
Coastal Communities	158	
Regional Housing Board	10	
Hastings and St Leonards Foreshore Charitable Trust	127	
East Sussex County Council	50	
Environment Agency	450	
Historic England	9	
Other Grants and Contributions	90	
		2,040
Reserves		934
Capital Receipts		697
Total		16,896

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Overall Borrowing Need (Capital Financing Requirement (CFR))

9. 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 debt position. The CFR results from the capital activity of the Council and what resources have been used to pay for the capital spend.

10. Part of the Council's treasury activities is to address the funding requirements for the Council's borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure 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.

11. 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 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. 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.

12. 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).

13. The Council's 2016/17 MRP Policy was approved as part of the Treasury Management Strategy Report for 2016/17 by Council in February 2016.

14. 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 this scheme.

Table 2 CFR: General Fund	2015/16 Actual £000's	2016/17 Estimate £000's	2016/17 Actual £000's
Opening balance	18,574	18,352	18,064
Add unfinanced capital expenditure	300	13,225	13,225
Less repayments (LAMS)			(1,000)
Less MRP	(501)	(505)	(505)
Less finance lease arrangements	(9)	(9)	(0)
Closing balance	18,064	31,063	29,783

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

16. The Council's long term borrowing must only be for a capital purpose. This essentially means that the Council is not borrowing to support revenue expenditure. Net borrowing should not therefore, except in the short term, have exceeded the CFR for 2016/17 plus the expected changes to the CFR over 2017/18 and 2018/19 from financing the capital programme. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs in 2016/17. The table below highlights the Council's gross borrowing position against the CFR, which provides an indication of affordability for the Council. The Council has complied with this prudential indicator.

Table 3 Internal Borrowing Level	2015/16 Actual	2016/17 Estimate	2016/17 Actual
	£000's	£000's	£000's
Capital Financing Requirement	18,574	31,063	29,783
External Borrowing	14,197	20,483	26,469
Net Internal Borrowing	4,377	10,580	3,314

Treasury Position as at 31 March 2017

17. The Council's debt and investment position at the beginning and the end of the year was as follows:

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Debt	1 April 2016 Principal	Rate	Maturity	31-Mar-17 Principal	Rate
PWLB Loan 1	£7,500,000	4.80%	2033	£7,500,000	4.80%
PWLB Loan 2	£1,000,000	2.02%	2016		
PWLB Loan 3	£1,000,000	1.63%	2018	£1,000,000	1.63%
PWLB Loan 4	£2,000,000	0.56% (Variable)	2019	£2,000,000	0.40% (*Variable)
PWLB Loan 5	£909,027	3.78%	2044	£909,027	3.78%
PWLB Loan 6	£1,788,235	3.78%	2044	£1,788,235	3.78%
PWLB Loan 7 (Annuity)	£300,000	1.66%	2026	£272,182	1.66%
PWLB Loan 8			2056	£1,000,000	2.92%
PWLB Loan 9			2046	£1,000,000	3.08%
PWLB Loan 10			2036	£1,000,000	3.01%
PWLB Loan 11			2026	£1,000,000	2.30%
PWLB Loan 12			2054	£2,000,000	2.80%
PWLB Loan 13			2028	£1,000,000	2.42%
PWLB Loan 14			2057	£2,000,000	2.53%
PWLB Loan 15			2059	£2,000,000	2.50%
PWLB Loan 16			2060	£2,000,000	2.48%
Total Debt	£14,497,262	3.55%		**£26,469,444**	3.15%

* Rate at January 2017 (rates change every 3 months)

Table 5 **Investments**	31st March 2016 Principal	31st March 2017 Principal
-In-House *	£22.5m	£27.8m
Total Investments*	£22.5m	£27.8m

* excludes deposits held in respect of the Local Authority Mortgage Scheme

Performance Measurement (2016-17)

18. Table 6 below compares the Estimated Interest Payable and Received and associated fees for the year 2016-17.

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Table 6	2015 -16 Actual Outturn £000's	2016-17 Revised Budget £000's	2016 -17 Actual Outturn £000's
Gross Interest Payable	509	675	686
Gross Interest Received	(302)	(223)	(301)
Fees	10	6	17
Other (e.g. PWLB Discount)	(53)	(51)	(51)
Net Cost	164	407	351

19. The net interest on the Local Authority Mortgage Scheme (LAMS), as detailed below, is being transferred into the Mortgage Reserve.

Table 7	2015 -16 Actual Outturn £000's	2016-17 Revised Budget £000's	2016-17 Actual Outturn £000's
Gross Interest Payable	36	31	31
Gross Interest Received	(64)	(54)	(54)
Net Surplus	(28)	(23)	(23)

20. The Council's longer term cash balances comprise, primarily, revenue and capital resources, although these will be influenced by cash flow considerations. The Council's core cash resources are detailed below, and were in line with budget expectations.

Table 8 Reserves	31 March 2016	31 March 2017
	£000's	£000's
General Fund Balance	500	500
Earmarked Reserves	12,650	12,063
General Reserve	7,537	7,520
Total	£20,187	£19,583

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It should be noted that Earmarked Reserves includes £1.264m (£1.706m at 31 March 2016) of Clinical Commissioning Group monies

The Strategy for 2016-17

21. The expectation for interest rates within the Treasury Management Strategy for 2016/17 anticipated that the historically low Bank Rate would be subject to gradual rises in medium and longer term and as such fixed borrowing rates would increase slowly 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.

22. 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.

23. The strategy adopted in the original Treasury Management Strategy report for 2016/17 approved by the Council in February 2016 was subject to revision in the year to amend the Minimum Revenue Provision policy to allow for a debt repayments based on an annuity methodology and an increase in the authorised borrowing limits. This followed the Council's acquisition of Muriel Matters House and the Sedlescombe Road North Retail Park in addition to the existing capital programme.

24. The treasury strategy had been to postpone borrowing to avoid the cost of holding higher levels of investments and reduce counterparty risk except where contractual arrangements with Amicus Horizon were involved. However, with the increased level of Capital expenditure on commercial property and the need to secure the net income streams for future years, along with an under borrowed position that the Council held, new borrowing was undertaken in the year, in order to minimise costs in the long term..

25. The general aim of the treasury management strategy is to minimise the costs of borrowing in both the short and longer term. In the short term it can consider avoiding new borrowing and using cash balances to finance new borrowing. However to minimise longer term costs it needs to borrow when rates are a historically low levels. Given also that the Council's ambitions are to generate future income streams, which would involve future borrowing, the opportunities were taken to secure new borrowing in the year. The timing of new borrowing is therefore important to minimise the overall costs to the Council.

26. The 2016/17 strategy stated that the short term savings achieved through avoiding new long term external borrowing in 2016/17 would be weighed against the potential for incurring additional long term extra costs by delaying new external borrowing until later years when PWLB long term rates were forecast to

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be significantly higher. The strategy stated that a balanced position would be sought in 2016/17.

The Economy and Interest Rates

27. 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.

28. 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.

Borrowing Rates in 2016-17

29. PWLB borrowing rates - the graphs and table for PWLB maturity rates below show, for a selection of maturity periods, the high and low points in rates, the average rates, spreads and individual rates at the start and the end of the financial year.

30. The graph highlights the historically low rates in the year, following the Brexit vote.

Table 9: PWLB rates

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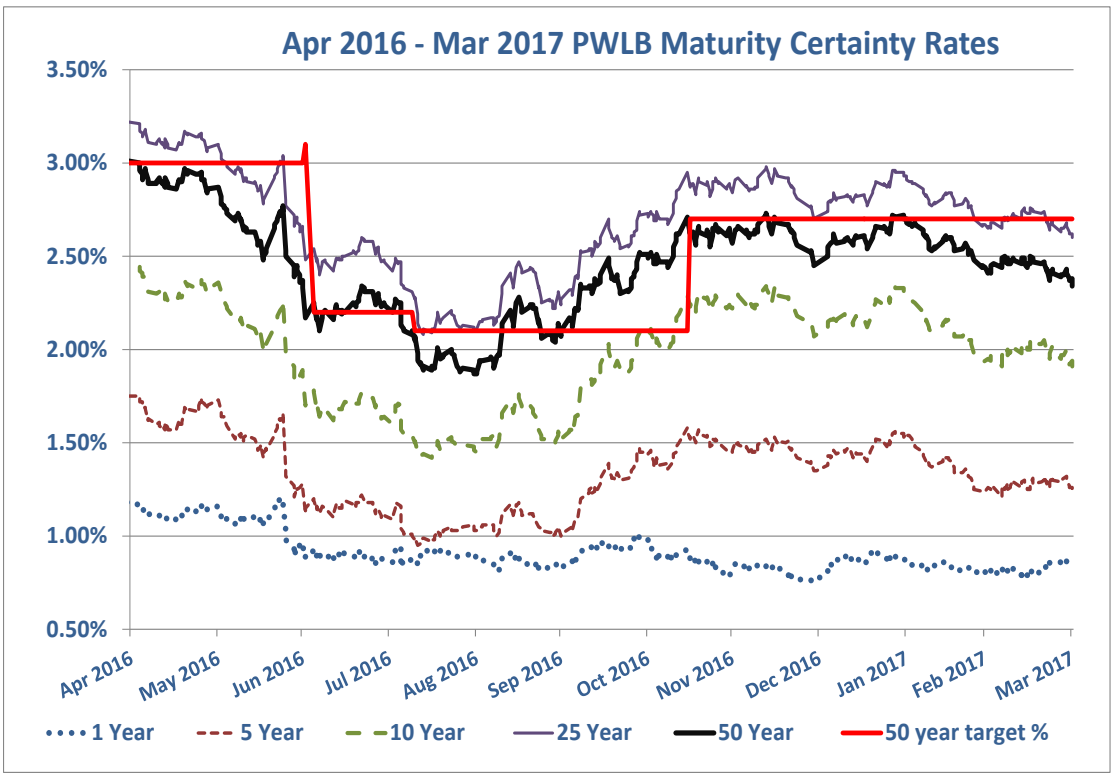

31. The table above highlights the fluctuation in borrowing rates throughout the year for different borrowing periods (in years).

Borrowing Outturn for 2016/17

32. Additional long term borrowing £of £13.225m was undertaken in 2016/17 in respect of the Muriel Matters House, the BD Foods Factory and Sedlescombe Road North Retail Park.

33. The first loan in respect of the Local Authority Mortgage scheme was repaid (after 5 years) in December 2016 (£1million). This loan was taken out to fund the first tranche of the Local Authority Mortgage scheme and was matched with a deposit of £1m with Lloyds Bank at an interest rate of 4.45% (repaid to the Council in January 2017).The remaining £1million loan is due to be repaid in 2018.

Debt Rescheduling

34. The Council examined the potential for making premature debt repayments in order to reduce borrowing costs as well as reducing counterparty risk by reducing investment balances. No rescheduling was undertaken during the year as the differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

Compliance with Treasury Limits

35. During the financial year the Council operated within the treasury limits and Prudential Indicators set out in the Council's annual Treasury Strategy Statement. The outturn for the Prudential Indicators is shown in Appendix 1.

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Investment Rates in 2016-17

36. 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.

37. The funds invested during the year were often available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the capital programme.

Investment Strategy

38. The strategy was effectively amended at the Council meeting in February 2017, enabling investments to be made in the CCLA Property Fund (£2m invested in April 2017). Other than this the Investment strategy did not change during the year, other than Investment returns being lower and for a longer period than previously anticipated.

Investment Outturn for 2016-17

39. Investments held by the Council - the Council maintained an average balance in the year of £27.4m. The average rate of return for the year was 0.61% (0.81% including LAMS scheme deposits). The comparable performance indicator is the average 7-day LIBID rate (un-compounded), which was 0.2%.

40. The table below provides a snapshot of the investments/deposits held at 31 March 2017.

Counterparty	Rate/ Return (%)	Start Date	End Date	Principal (£)	Term
NatWest	0.01			74,694	Call
NatWest	0.10			5,000,021	Call
Lloyds Bank	1.05	11/05/2016	11/05/2017	5,000,000	Fixed
National Australia	0.76	03/06/2016	05/06/2017	3,000,000	Fixed
Toronto	0.55	16/08/2016	16/05/2017	5,000,000	Fixed
Nordea	0.43	30/09/2016	30/06/2017	5,000,000	Fixed
Barclays	0.40			2,957,814	Call
Lloyds Gen	0.40			1,765,170	Call
			Total	27,797,699	

41. The above table excludes the remaining £1million deposit that is held with Lloyds Bank as part of the Local Authority Mortgage scheme (LAMS); the

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deposit being held for a period of 5 years. The last one provides a rate of return of 1.97% and matures on 23 March 2018.

42. In addition to the investments the Council has a few loans in place, namely as at 31 March 2017:-

Counterparty	Rate/ Return (%)	Start Date	End Date	Principal (£)	Term
Amicus	3.78	04/09/2014	02/09/2044	1,788,235	Fixed
The Source	2.43	17/12/2015	17/12/2025	20,471	Fixed
Foreshore Trust	1.66	21/03/2016	20/03/2026	243,900	Annuity

43. One loan of £127,000 to the Foreshore Trust was cancelled in March 2017 following the successful conclusion of the land swap at West Marina

44. No institutions in which investments were made during 2016/17 had any difficulty in repaying investments and interest in full during the year.

Financial Implications

45. The security of the Council's monies remains the top priority within the strategy. Investment rates available in the market have continued at historically low levels and have fallen further during the last year. There has been new borrowing of £13.225m on which the borrowing costs are more than offset by the rental income received.

Wards Affected

Ashdown, Baird, Braybrooke, Castle, Central St. Leonards, Conquest, Gensing, Hollington, Maze Hill, Old Hastings, Ore, Silverhill, St. Helens, Tressell, West St. Leonards, Wishing Tree

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Policy Implications

Please identify if this report contains any implications for the following:

Equalities and Community Cohesiveness	No
Crime and Fear of Crime (Section 17)	No
Risk Management	No
Environmental Issues	No
Economic/Financial Implications	Yes
Human Rights Act	No
Organisational Consequences	No
Local People's Views	No
Anti-Poverty	No

Additional Information

Treasury Management and Annual Investment Strategy 2016/17

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CIPFA - Treasury Management Code of Practice (revised 2009)
CIPFA - The Prudential Code (revised 2009)

Appendix 1 – Prudential Indicators

Officer to Contact

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Officer Telephone Number 01424 451503

Appendix 1: Prudential Indicators

The Council's Capital expenditure plans are the key driver of treasury management activity. The output of the Capital expenditure plans (detailed in the budget) is reflected in the prudential indicators below.

PRUDENTIAL INDICATOR	2015/16	2016/17*	2017/18	2018/19	2019/20
(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	£'000	£'000	£'000	£'000	£'000
Authorised Limit for external debt -					
borrowing	£20,000	£35,000	£65,000	£75,000	£85,000
other long term liabilities	£10,000	£5,000	£5,000	£5,000	£5,000
TOTAL	£30,000	£40,000	£70,000	£80,000	£90,000
Operational Boundary for external debt -					
borrowing	£20,000	£35,000	£65,000	£75,000	£85,000
other long term liabilities	£10,000	£ 5,000	£ 5,000	£ 5,000	£ 5,000
TOTAL	£30,000	£40,000	£70,000	£80,000	£90,000
Upper limit for fixed interest rate exposure Net principal re fixed rate borrowing / investments OR:-	100 %	100 %	100 %	100 %	100 %
Upper limit for variable rate					

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exposure Net principal re variable rate borrowing / investments OR:-	100 %	100%	100%	100%	100%
Upper limit for total principal sums invested/deposited for over 364 days e.g.LAMS Scheme, Coastal Space	£5,620	£6,000	£9,000	£9,000	£9,000
	2016/17* - revision to operational and authorised boundaries from £30m to £40m.				

Maturity structure of fixed rate borrowing during 2016/17	upper limit	lower limit
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%

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