APPENDIX A

Annual Treasury Management Review 2016/17

PENDLE BOROUGH COUNCIL

August 2017

Annual Treasury Management Review 2016/17

1. Introduction

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).

During 2016/17 the minimum reporting requirements included the following reports:

- an annual treasury strategy in advance of the year (Council 23/03/2016)
- a mid-year (minimum) treasury update report (Executive 17/11/2016)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

In addition, quarterly treasury management monitoring reports have been presented to the Accounts and Audit Committee providing information on the treasury activity undertaken and demonstrating compliance with the strategy approved by Council.

The regulatory environment places responsibility on Councillors 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 Councillors.

2. The Economy and Interest Rates

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.

3. Overall Treasury Position as at 31 March 2017

At the beginning and the end of 2016/17 the Council's treasury position was as follows:

TABLE 1	31 March 2016 Principal £m	Rate/ Return	Average Life yrs	31 March 2017 Principal £m	Rate/ Return	Average Life yrs
Total debt	**15.4**	**3.41%**	**16.4**	**16.4**	**3.34%**	**17.7**
CFR	**13.8**			**15.4**		
Over / (under) borrowing	**1.6**			**1.0**		
Total investments	**17.8**	**0.46%**	**All <1yr**	**17.5**	**0.34%**	**All <1yr**
Net debt / (investment)	**(2.4)**			**(1.1)**		

4. The Strategy for 2016/17

The expectation for interest rates within the treasury management strategy for 2016/17 anticipated low but rising Bank Rate, (starting in quarter 1 of 2017) 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.

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.

The Annual Investment Strategy adopted in the original Treasury Management Strategy Report for 2016/17 approved by the Council in March 2016 was subject to revision during the year. This was due to the UK's sovereign rating being downgraded by the main rating agencies following the EU referendum and thus falling below the approved minimum investment criteria. Council resolved, at its meeting of 14th July 2016, to remove the UK sovereign rating from the minimum sovereign rating criterion.

5. The Borrowing Requirement and Debt

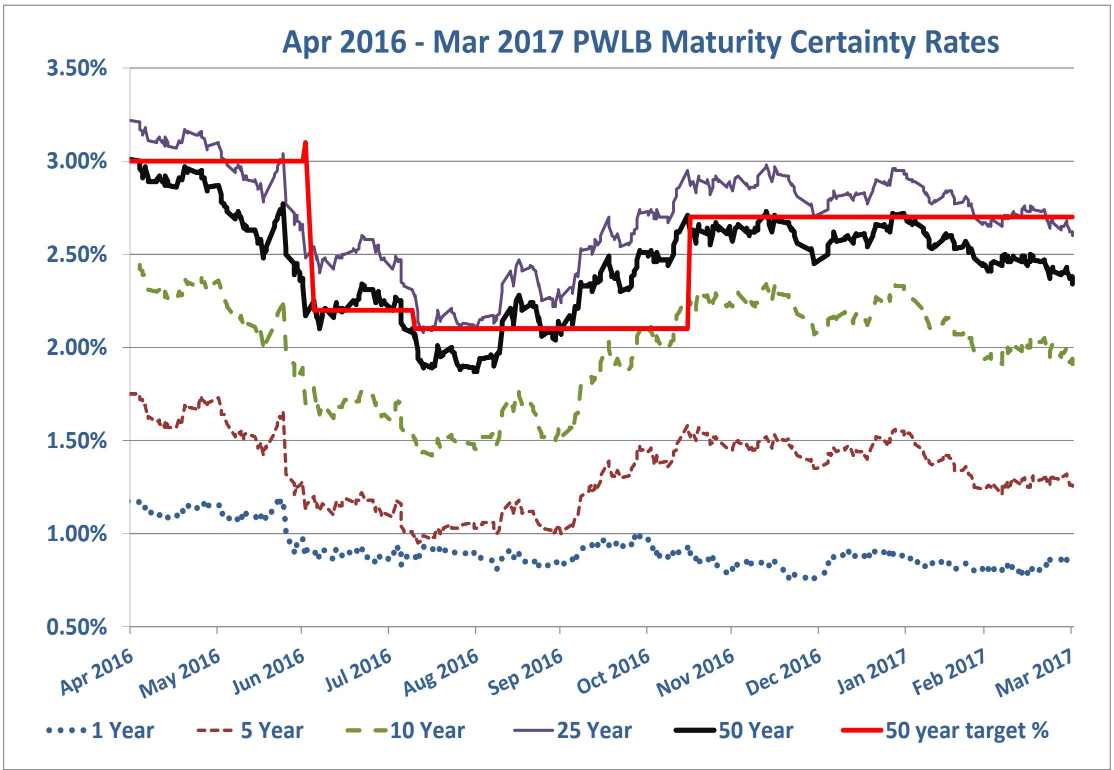
The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).

	31 March 2016 Actual	31 March 2017 Budget	31 March 2017 Actual
CFR General Fund (£m)	13.8	21.8	15.4

The variance from actual to budget for 2016/17 is due to the significant slippage on the capital programme in the year. This delays the associated borrowing 'need' as expressed by the Capital Financing Requirement.

6. Borrowing Rates in 2016/17

PWLB certainty maturity borrowing rates - the graph below shows how PWLB certainty rates have fallen to historically very low levels during the year.



7. Borrowing Outturn for 2016/17

Borrowing – the following loans were taken during the year: -

Lender	Principal	Type	Interest Rate	Maturity
PWLB	£1m	Fixed interest rate	2.14%	46.0 years

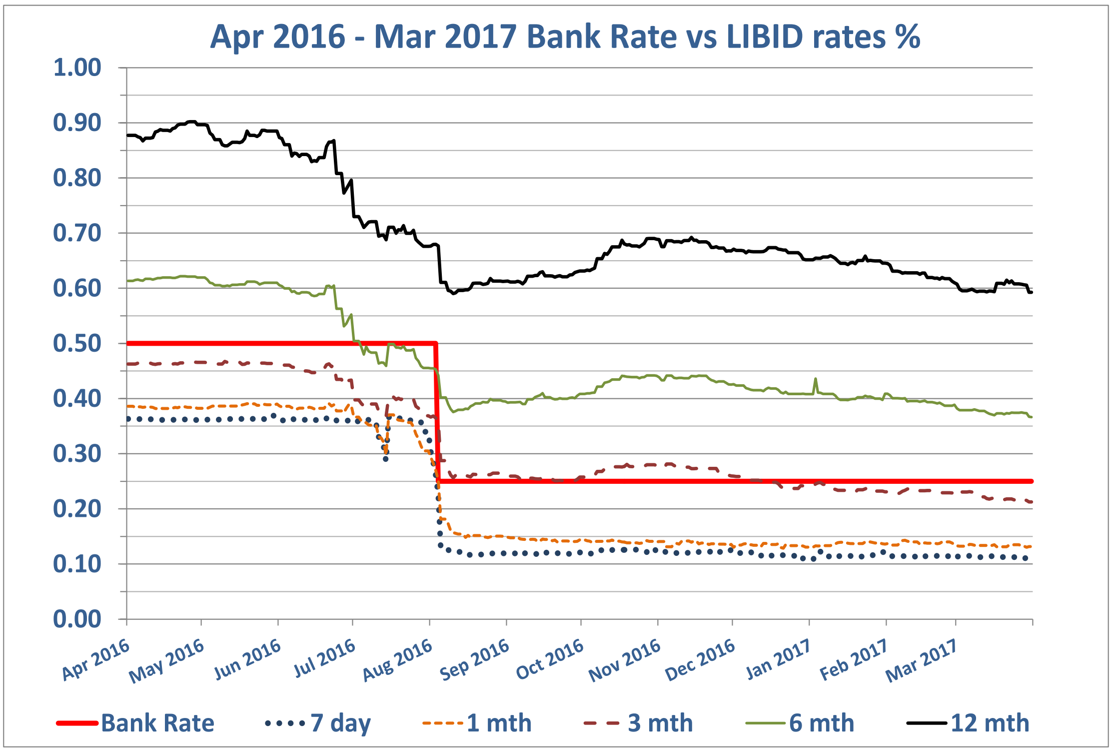
The Treasury Strategy approved by Council in March 2016 envisaged net additional borrowing of £3.5m during 2016/17 comprised of net 'normal' borrowing of £2m and a further £1.5m to support the Brownfield Regeneration Fund. This latter borrowing was not progressed in the year and only £1m of 'normal' borrowing was undertaken in 2016/17.

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

Repayments
No loan repayments were made during the year.

8. 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.



9. Investment Outturn for 2016/17

Investment Policy – the Council's investment policy is governed by CLG guidance, which has been implemented in the annual investment strategy approved by the Council in March 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.

Investments held by the Council - the Council maintained an average balance of £22m of internally managed funds. The internally managed funds earned an average rate of return of 0.42%. Comparable performance indicators are the average 7-day LIBID rate, which was 0.20% or the 3-Month LIBID rate which was 0.32%. This compares with a budget assumption of £20m investment balances earning an average rate of 0.40%.

Appendix 1: Prudential and Treasury Indicators

During 2016/17, the Council complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2016/17) plus the estimates of any additional capital financing requirement for the current (2017/18) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs in 2016/17.

The authorised limit - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level. The table below demonstrates that during 2016/17 the Council has maintained gross borrowing within its authorised limit.

The operational boundary – 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.

Actual financing costs as a proportion of net revenue stream - this indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

1. PRUDENTIAL INDICATORS	2015/16	2016/17	2016/17
Extract from budget setting report	**actual**	**original**	**actual**
	£'000	**£'000**	**£'000**
Capital Expenditure			
General Fund	2,511	7,948	4,013
Ratio of financing costs to net revenue stream	**6.45%**	**7.70%**	**6.83%**
Gross borrowing requirement General Fund			
brought forward 1 April	14,286	15,149	13,782
carried forward 31 March	13,782	21,831	15,406
in year borrowing requirement	(504)	6,682	1,624
Capital Financing Requirement	13,781	21,831	15,406
Gross debt	15,359	18,993	16,359
Incremental impact of capital investment decisions			
Increase in council tax (band D) per annum	£37.03	£11.91	£15.22

	2016/17
Authorised limit	£23.5m
Maximum gross borrowing position	£16.5m
Actual gross borrowing at 31/3/17	£16.49m
Operational boundary	£22.5m
Average gross borrowing position	£16.2m
Financing costs as a proportion of net revenue stream	6.83%

The maturity structure of the debt portfolio was as follows:

	31 March 2016 actual	2016/17 original limits (upper)	31 March 2017 actual
Under 12 months	£0.00m (0%)	25%	£1.00m (6%)
12 months and within 24 months	£1.00m (6%)	30%	£0.00m (0%)
24 months and within 5 years	£2.00m (13%)	40%	£3.00m (18%)
5 years and within 10 years	£5.50m (36%)	60%	£4.50m (28%)
Over 10 years	£6.86m (45%)	100%	£7.86m (48%)

The maturity structure of the investment portfolio was as follows:

	2015/16 Actual £m	2016/17 Original £m	2016/17 Actual £m
Investments All investments under 1 year	17.8	20.0	17.5

Upper limits for exposure to fixed and variable rates of interest were as follows:

	31 March 2016 Actual £000	2016/17 Original Limits £000	31 March 2017 Actual £000
Fixed rate (principal or interest) based on net debt	104%	100%	102%
Variable rate (principal or interest) based on net debt	-4%	25%	-2%
Upper Limits on fixed interest rates based on net debt (with variable rates shown in brackets):			
• Debt only	100% (0%)	100% (25%)	100% (0%)
• Investments only	78% (22%)	100% (25%)	85% (15%)