Report to	Cabinet	**Item**
Report of	Chief finance officer	11
Subject	Treasury Management Full Year Review Report 2016-17	

Purpose

This report sets out the Treasury Management performance for the year to 31 March 2017.

Recommendation

To recommend that council:

1) Approves the actual 2016/17 prudential and treasury indicators in this report; and

2) Notes the Annual Treasury report for the year 31 March 2017.

Financial implications

The report has no direct financial consequences however it does report on the performance of the council in managing its borrowing and investment resources.

Ward/s: All wards

Cabinet member: Councillor Kendrick, resources

Contact officers

Karen Watling, chief finance officer	01603 212440
Tina Stankley, senior technical accountant interim	01603 212562

Background documents

None

Report

Background

1. The Council is required by regulations issued under the Local Government Act 2003 to produce an annual review of its treasury management 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. This report details the results of the council's treasury management activities for the financial year 2016-17. It compares this activity to the Treasury Management Strategy for 2016-17, approved by Full Council on 23 February 2016. It will also detail any issues that have arisen in treasury management during this period.

Introduction

3. Treasury Management relates to the policies, strategies and processes associated with managing the cash and debt of the Council through appropriate borrowing and lending activity. It includes the effective control of the risks associated with the lending and borrowing activity and the pursuit of optimum performance consistent with the risks.

4. For the 2016/17 financial year the minimum reporting requirements were that full Council should receive the following reports:
    - an annual Treasury Management Strategy in advance of the year (Council 23 February 2016.
    - a mid-year Treasury Management Review report (Cabinet 14 December 2016).
    - an annual review following the end of the year describing the activity compared to the strategy (this report).

5. The regulatory environment places responsibility on members to review and scrutinise 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 which have previously been approved by members. This report summarises the following:-
    - Capital activity during the year (section 3)
    - Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement) (section 4)
    - The actual prudential and treasury indicators (section 4)
    - Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances (section 5)
    - Review of treasury strategy and economic factors (sections 6 & 7)
    - Borrowing rates and detailed debt activity (sections 8 & 9)
    - Investment rates and detailed investment activity (section 10)

The Council's Capital Expenditure and Financing 2016-17

6. The capital programme was revised during 2016-17 from that agreed by full council at its meeting on 23 February 2016. The revised capital programme was reported in the mid-year Treasury Management Review report which was presented to cabinet on 14 December 2016. Actual spending was under budget for the year by £25.345m. Consequently the actual level of revenue and borrowing needed to finance the expenditure was less than that estimated. The actual capital expenditure forms one of the required prudential indicators. The table below shows the estimates and then the actual capital expenditure for 2016-17 and how this was financed in the year:

Capital Expenditure	**2016/17 Original Estimate £m**	**2016/17 Revised Estimate £m**	**2016/17 Actual £m**	**(Underspend) /Overspend** £m
Non-Housing Capital expenditure	35,164	23,574	6,600	(16,974)
HRA Capital expenditure	47,340	35,506	27,135	(8,371)
	82,504	59,080	33,735	(25,345)
Financed by				
Capital Receipts	11,682	11,709	3,692	(8,017)
Capital Grants	8,812	8,045	5,441	(2,604)
Capital Reserves	2,423	1,050	-	(1,050)
Revenue	26,104	26,104	11,049	(15,055)
HRA Non-dwelling Depreciation			13,553	13,553
	49,021	46,908	33,735	(13,173)
Borrowing need for the Year	33,483	12,172	-	(12,172)

7. Capital expenditure may either be:

- Financed immediately through the application of capital or revenue resources e.g. capital receipts, capital grants, revenue contributions etc.), which has no 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, which will be satisfied by either external or internal borrowing.

Council's overall borrowing need

8. The council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). The CFR arises as the Council incurs capital spending and then if it does not apply resources immediately to finance the capital spend, i.e. capital receipts, capital grants, capital reserves or revenue, a borrowing need arises. The 2016-17 CFR year-end balance is the cumulative total of the 2016-17 unfinanced capital expenditure (nil for 2016-17), and prior years' unfinanced capital.

9. Treasury Management includes addressing the funding requirements for this borrowing need; it also includes maintaining a cash position to ensure sufficient cash is available to meet the capital expenditure and cash flow requirements. This

may be sourced through borrowing from external bodies, e.g. the Government through the Public Works Loan Board (PWLB) or the money markets, or utilising temporary cash resources within the Council (known as internal borrowing).

10. Reducing the CFR – the council's (non-HRA) 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. This requirement is met by making an annual revenue charge, called the Minimum Revenue Provision (MRP), to reduce the CFR. This is effectively a repayment of the non-HRA borrowing need (there is no statutory requirement to reduce the HRA CFR).

11. The total CFR can also be reduced by either:

- the application of additional capital financing resources (such as unapplied capital receipts)
- charging more than the statutory MRP each year through a Voluntary Revenue Provision (VRP).

	2016/17 Original Estimate	**2016/17 Revised Estimate**	**2016/17 Actual**
General Fund	**£m**	**£m**	**£m**
Opening balance	38.746	19.121	32.508
Add: Unfinanced capital expenditure (as above)	24.373	13.812	(0.064)
Less: MRP	(0.250)	(0.250)	(0.363)
Closing balance	62.869	32.683	32.081
	2016/17 Original Estimate	**2016/17 Revised Estimate**	**2016/17 Actual**
HRA	**£m**	**£m**	**£m**
Opening balance	207.286	207.333	206.480
Add: Unfinanced capital expenditure (as above)	9.110	(0.853)	(0.856)
Less: Finance lease repayments		-	-
Closing balance	216.396	206.480	205.624

12. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External borrowing can be taken or repaid at any time, but this does not change the CFR.

13. The Council's CFR for the year is shown below, and is a key prudential indicator. It includes PFI and leasing schemes on the balance sheet, which increase the Council's borrowing need. No borrowing is actually required against these schemes as a borrowing facility is included in the contract.

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

The actual prudential and treasury indicators

15. **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. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

	2016/17 Original Estimate £m	**2016/17 Revised Estimate £m**	**2016/17 Actual £m**
Gross borrowing	254.779	227.701	209.897
CFR	279.265	239.162	237.705

16. **The authorised limit -** the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. 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.

	2016/17 Original Estimate	**2016/17 Revised Estimate**	**2016/17 Actual**
Authorised Limit for external debt	**£m**	**£m**	**£m**
Borrowing	293.107	263.917	263.917
Other long term liabilities	1.672	1.672	1.672
Total	294.779	265.589	265.589
Operational boundary for external debt	**£m**	**£m**	**£m**
Borrowing	253.107	224.083	224.083
Other long term liabilities	1.672	1.762	1.762
Total	254.779	225.845	225.845
	£m	**£m**	**£m**
Actual external debt	254.779	225.845	209.897

17. 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

18. This indicator identifies the shows what the cost of capital is (borrowing and other long term obligation costs net of investment income) as a percentage of the net revenue stream. For the general fund the net revenue stream is the amount that is funded by government grants and council tax payers. For the HRA the net revenue stream is the rental income paid by tenants.

Affordability of financing costs	2016/17 Estimate	2016/17 Actual
General fund - financing costs as a percentage of net revenue stream	7.67%	3.71%
HRA - financing costs as a percentage of rental income	10.65%	13.13%

Treasury Position as at 31 March 2017

19. The Council's debt and investment position is managed by the treasury management service. All activities are undertaken primarily to ensure security for investments, adequate liquidity for revenue and capital activities, and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through member reporting detailed in the summary, and through officer activity detailed in the Council's Treasury Management Practices.

20. The council's actual borrowing position at 31 March 2017 and activity during 2016-17 is detailed in the table below:

Borrowing activity 2016-17 (excluding PFI/finance leases)	PWLB loans £m	Market loans £m	Total £m	Average interest rate %
Opening balance 01.04.16	213.857	5.000	218.857	4.29%
New borrowing taken in 2016-17	-	-	-	
Borrowing matured/repaid in 2016-17	(10.750)	-	(10.750)	
Closing balance 31.03.17	203.107	5.000	208.107	4.45%
Authorised limit for external debt			293.107	

21. The maturity structure of the debt portfolio was as follows:

Maturity Structure of fixed rate borrowing	Upper Limit per Strategy %	31-Mar-17 %	£m
Under 12 months	10%	1.43%	2.993
Between 12 months and 2 years	10%	2.39%	5.000
Between 2 years and 5 years	30%	0.96%	2.000
Between 5 years and 10 years	50%	57.70%	120.659
Over 10 years	95%	37.52%	78.448
Total borrowing			209.100

22. The difference between the closing balance of £208.107m in paragraph 6.2 above and the total of £209.987m debt disclosed in the table in paragraph 5.2 above is that the debt repayable within 12 months also includes accrued interest of £0.993m for the PWLB & Barclays loans and other liabilities of £0.796m which is largely relates to a perpetually irredeemable 3% loan stock valued at £0.5m.

23. The following table shows the movement in investments in the year.

Investments	Actual 31 March 2016	Net movements in year	Transferred between long term & short term	Actual 31 March 2017
	£m	£m	£m	£m
Long Term				
Banks	3.000	-	(3.000)	-
Short term				-
Banks	10.000	18.000	-	28.000
Building Societies	25.000	0.100	2.300	27.400
Local Authorities	-			-
Cash Equivalents				-
Banks	10.000	0.660		10.660
Building Societies	2.300		(2.300)	-
Local Authorities	8.000	(0.500)		7.500
Total	**58.300**	**18.260**	**(3.000)**	**73.560**

24. The maturity structure of the investment portfolio was as follows:

£'000	31-Mar-17 £m	31-Mar-16 £m
Longer than 1 year		3.000
Under 1 year	73.560	55.300
	73.560	**58.300**

The Strategy for 2016-17

25. The expectation for interest rates within the treasury management strategy for 2016/17 anticipated low but rising Bank Rate, (with the first increase anticipated to be in June 2016), and gradual rises in medium and longer term fixed borrowing rates during 2016/17.

26. Investment returns were expected to remain relatively low during 2016/17 and beyond. Investments would continue to be dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

27. Against this background and the risks within the economic forecast, a cautious approach will be adopted with the 2016/17 treasury operations. The Chief finance officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances. The treasury strategy would be as to postpone borrowing to avoid the cost of holding higher levels of investments and to reduce counterparty risk.

The Economy and Interest Rates

28. At the time of setting the Strategy in February 2016, the markets were forecasting short-term Bank Rate to increase to 0.75% from 0.50% by December 2016 for the first time since 2008, in response to the low inflation strong growth environment in the UK. However this first increase was pushed further into the future following the Bank of England Inflation Report in May 2016, which pegged back its growth forecast and factored in concerns over a Brexit vote to leave.

29. Long term rates were forecast to rise moderately over 2016/17 by around 0.30%, but remain extremely volatile and difficult to predict due to upside and downside external market influences. There were two major landmark events that had a significant influence on financial markets during the year. This was the UK EU referendum on 23 June 2016 and the election of President Trump in the USA on 9 November 2016

30. The UK voted to leave the European Union in the 23 June 2016 referendum. Shocks to the markets subsequent to this result and fears for Economic Growth led the Bank of England (BOE) to cut Base Rate on 4 August 2016 to 0.25% from 0.50%, for the first time since 2009, and increase Quantitative Easing (QE) by £60bn to £435bn. The graph shows the impact on interest rates due to these events. Short term rates dropped to 0.25% levels following the Base Cut and have remained flat since. Long term rates fell significantly after the Brexit vote but have

rallied since September 2016 as growth and consumer confidence confounded the pessimistic forecasts of the BOE.

31. Annual growth for 2016 was 1.8%, better than most G7 countries. Retail sales was 2.3% in April 2017, 4% higher than a year ago. Inflation rose sharply due to the effects of the sharp devaluation of sterling after the referendum. CPI was 2.7% in March and sterling was 17% down against the dollar. As a result of these figures the BOE did not alter rates during the rest of the financial year, seeing no reason for a further cut or increase. Inflation is not being seen as a problem to address as unemployment fell to its lowest in 42 years (4.6%), subduing any wage inflation inherent in the economy.

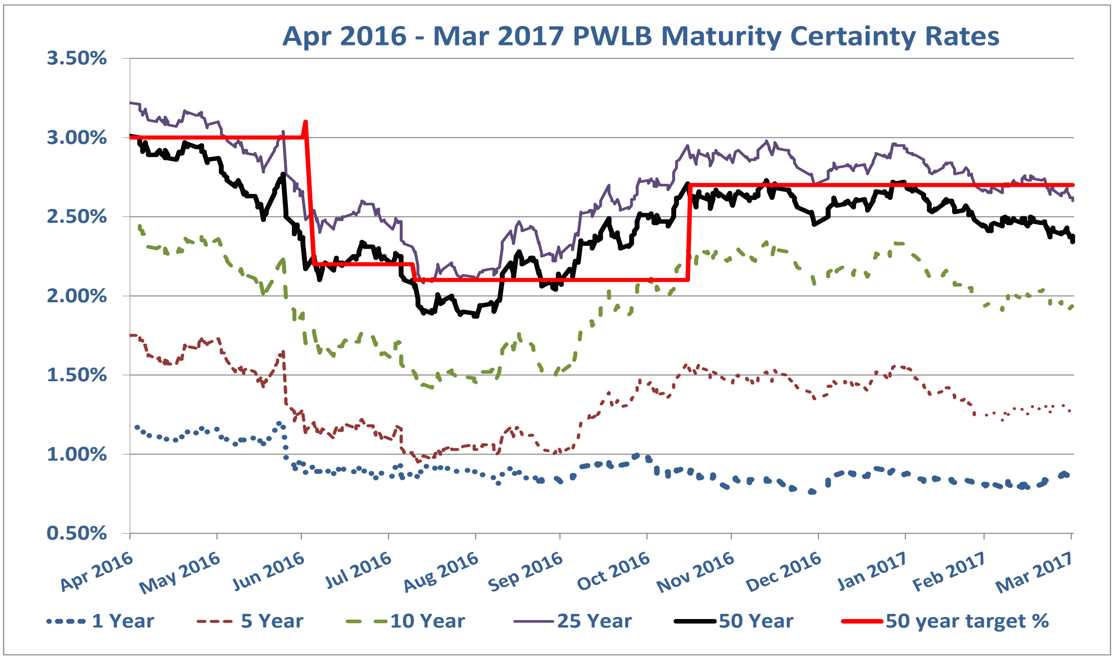
32. Market expectations for the first increase in Bank Rate moved forward to December 2018 by the end of March, in response to the increases in inflation, with the next increase in Base Rate not expected until June 2019.

33. The US voted for President Trump in their election on 9 November 2016. He has promised expansion of infrastructure expenditure in the US at the same time as promising to cut taxes. Stock markets in the US reached record highs since the election. The Fed raised interest rates by 0.25% in December 2016 to 0.75% in response to rising growth and inflation. Annual growth for the US was 1.6% in 2016.

34. The European Central Bank (ECB) announced its commitment to extend QE by another 9 months to December 2017 and cut rates to negative territory in an attempt to boost the European economy and get inflation up from near zero levels. This resulted in an overall growth figure of 1.7% in 2016 for the EU, with Germany achieving a rate of 1.9%, the fastest growing G7 country.

Borrowing Rates in 2016-17

35. **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.

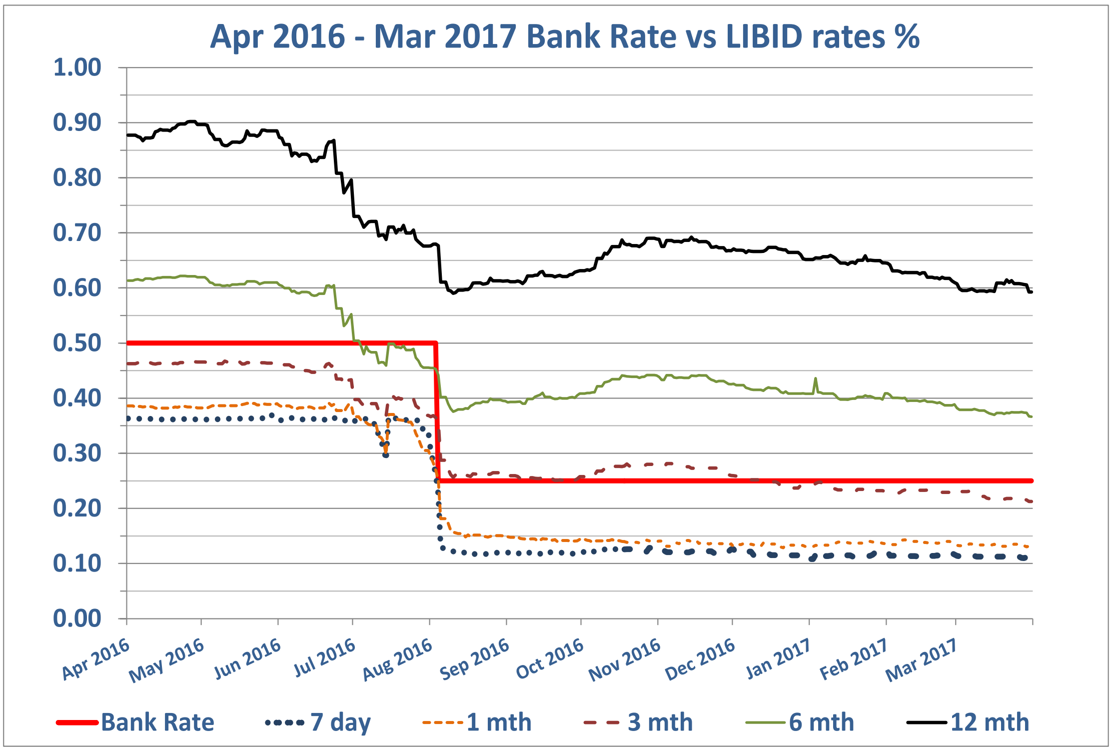


	1 Year	5 Year	10 Year	25 Year	50 Year
1/4/16	1.13%	1.62%	2.31%	3.14%	2.95%
31/3/17	0.83%	1.24%	1.91%	2.60%	2.34%
Low	0.76%	0.95%	1.42%	2.08%	1.87%
Date	20/12/2016	10/08/2016	10/08/2016	12/08/2016	30/08/2016
High	1.20%	1.80%	2.51%	3.28%	3.08%
Date	27/04/2016	27/04/2016	27/04/2016	27/04/2016	27/04/2016
Average	0.93%	1.36%	2.01%	2.72%	2.49%

Borrowing Outturn for 2016-17

36. Due to investment concerns about counterparty risk and low investment returns, no borrowing was undertaken during the year. However during 2016-17 £10.750m of PWLB debt was repaid.

37. During 2016-17 the council paid £9.5m in interest costs, this compares to a budget of £9.4m.



Investment Rates in 2016-17

38. After the EU referendum, the bank base rate was cut from 0.5% to 0.25% in August and has remained at that level since. 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. The 2015-16 low levels of Deposit rates continued into 2016-17, then continued to fall. This resulted in MPC at its August meeting making a large tranche of cheap financing 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.

Investment Outturn for 2016-17

39. The Council's investment policy is governed by CLG guidance, which was implemented in the annual investment strategy approved by the Council on 23 February 2015. 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 [a financial swap agreement that the seller of the CDS will compensate the buyer in the event of a loan default or other credit event]., bank share prices etc.).

40. The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

Resources

41. The Council's cash balances comprise revenue and capital resources and cash flow monies. The Council's core cash resources comprised:

Balance Sheet Resources	**31-Mar-17**	**31-Mar-16**
	£m	**£m**
Balances	44.727	38.347
Earmarked Reserves	3.699	3.935
Useable Capital receipts	26.554	17.313
Capital grants Unapplied	4.879	3.200
Total	**79.859**	**62.795**

Investments held by the Council

42. The Council's year-end balance was £73.560m of internally managed funds. The internally managed funds earned an average rate of return of 0.75%. The target performance indicator was the average 7-day LIBID rate for the year, which was 0.20%.

43. The Council is part of a benchmarking group (run by our treasury management advisors, Capita Asset Services) across Norfolk, Suffolk & Cambridgeshire. The table below shows the performance of the Council's investments when compared with this benchmark group, and also when compared with the non-metropolitan districts and all authorities that use Capita's benchmarking group facility.

Capita benchmarking - position at 31 March 17				
	Norwich	**Benchmark group (11)**	**Non-met districts(87)**	**All authorities (218)**
WARoR[1]	0.75%	0.69%	0.57%	0.55%
WA Risk[2]	5.13	4.25	3.71	3.4
WAM[3]	149	121	105	97
WATT[4]	283	249	204	197

44. The council's average investments return (0.75%) is higher than that for the benchmark group (0.69%), and it was also higher than both the 87 non-met authorities at 0.57% and the population of 218 local authorities at 0.55%.

1 WARoR – Weighted average rate of return. This is the average annualised rate of return weighted by the principle amount in each rate

2 WA Risk – Weighted average risk number. Each institution is assigned a colour to a suggested duration using Sector's credit methodology. The institution is assigned a number based on its colour and an average, weighted using principal amount, of these numbers is calculated. A number of 5.13 means between 0 to 3 months

3 WAM Weighted average time to maturity. This is the average time, in days, until the portfolio matures, weighted by the principle amount

4 WATT – Weighted average total time. This is the average time, in days, that deposits are lent out for, weighted by the principle amount

# Integrated impact assessment	NORWICH City Council

The IIA should assess **the impact of the recommendation** being made by the report
Detailed guidance to help with completing the assessment can be found here. Delete this row after completion

Report author to complete	
Committee:	Cabinet
Committee date:	11 October 2017
Head of service:	Karen Watling
Report subject:	Full Year Treasury Management Report
Date assessed:	28 September 2017
Description:	This report is to inform members of the actual treasury activity for the year and compares that to the treasury management indicators set in the Treasury Management Strategy for 2016-17.

	Impact			
Economic (please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Finance (value for money)	☐	☒	☐	The report has no direct financial consequences however it does report on the performance of the Council in managing its borrowing and investment resources
Other departments and services e.g. office facilities, customer contact	☒	☐	☐	
ICT services	☒	☐	☐	
Economic development	☒	☐	☐	
Financial inclusion	☒	☐	☐	
Social (please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Safeguarding children and adults	☒	☐	☐	
S17 crime and disorder act 1998	☒	☐	☐	
Human Rights Act 1998	☒	☐	☐	
Health and well being	☒	☐	☐	

	Impact			
Equality and diversity (please add an ‘x’ as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Relations between groups (cohesion)	☒	☐	☐	
Eliminating discrimination & harassment	☒	☐	☐	
Advancing equality of opportunity	☒	☐	☐	
Environmental (please add an ‘x’ as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Transportation	☒	☐	☐	
Natural and built environment	☒	☐	☐	
Waste minimisation & resource use	☒	☐	☐	
Pollution	☒	☐	☐	
Sustainable procurement	☒	☐	☐	
Energy and climate change	☒	☐	☐	
(Please add an ‘x’ as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Risk management	☒	☐	☐	

Recommendations from impact assessment
Positive
Negative
Neutral
Issues