

**REPORT TO:** Audit and Governance Committee

**MEETING DATE:** 20 June 2017

**BY:** Depute Chief Executive (Resources and People Services)

**SUBJECT:** Annual Treasury Management Review 2016/17

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**1 PURPOSE**

- 1.1 To update the committee on Treasury Management Activity during 2016/17.

**2 RECOMMENDATIONS**

- 2.1 Members are asked to note the report.

**3 BACKGROUND**

- 3.1 The Council is required by regulations issued under the Local Government Scotland Act 2003 to produce an Annual Treasury Management Review.
- 3.2 The attached review updates Members on the Treasury Management Activity during 2016/17.

**4 POLICY IMPLICATIONS**

- 4.1 There are no direct policy implications associated with this report; however the council's treasury management activity is determined by the policy framework set out in the approved Treasury Management Strategy.

**5 INTEGRATED IMPACT ASSESSMENT**

- 5.1 The subject of this report does not affect the wellbeing of the community or have a significant impact on equality, the environment or economy.

## **6 RESOURCE IMPLICATIONS**

- 6.1 Financial – There are no direct financial implications associated with this report however the Council's Treasury Management activity clearly has a significant impact on the management of the Council's financial resources.
- 6.2 Personnel - none
- 6.3 Other - none

## **7 BACKGROUND PAPERS**

- 7.1 Treasury Management Strategy 2016/17 to 2018/19 – East Lothian Council 23rd February 2016.

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<b>DATE</b>	6 June 2017

# **Annual Treasury Management Review**

## **2016/17**

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East Lothian Council

June 2017

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# Annual Treasury Management Review 2016/17

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## 1. Introduction

This Council is required by regulations issued under the Local Government in Scotland 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 were that the full Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 23/02/2016)
- a mid-year (minimum) treasury update report (Council 29/11/2016)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

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.

This Council confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Audit and Governance Committee.

## 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.

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### 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	Rate/ Return	Average Life yrs		31 March 2017 Principal	Rate/ Return	Average Life yrs
<b>Total debt</b>	<b>£337m</b>	<b>4%</b>	<b>23</b>		<b>£344m</b>	<b>4%</b>	<b>24.4</b>
<b>CFR</b>	<b>£385m</b>				<b>£387m</b>		
<b>Over / (under) borrowing</b>	<b>£(47)m</b>				<b>£(43)m</b>		
<b>Total investments</b>	<b>£10m</b>				<b>£10m</b>		
<b>Net debt</b>	<b>£337m</b>	<b>4%</b>			<b>£344m</b>	<b>4%</b>	

The Gross Capital Financing Requirement includes PPP and finance leases but as there are no capital borrowing requirements associated with these elements they are not included within the Treasury CFR. The Council Gross CFR at the 31 March 2017 is £428m.

### 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 4 of 2016) 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.

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.

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.

## 5. The Borrowing Requirement and Debt

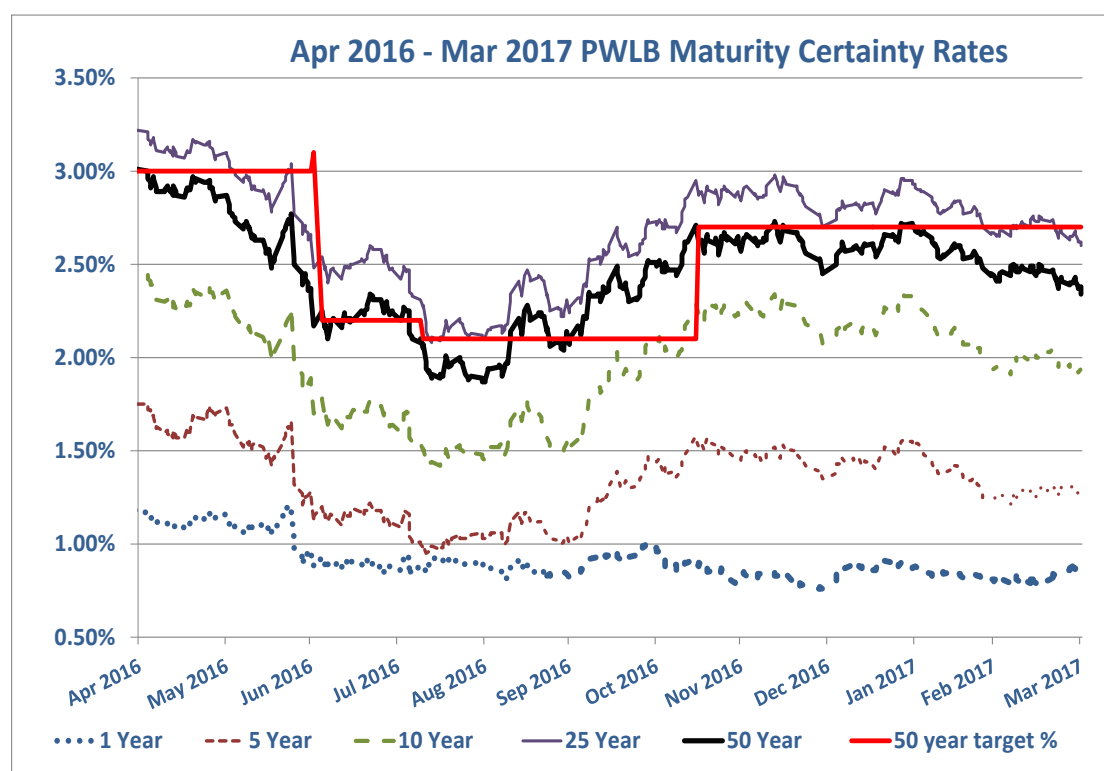
The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).

	31 March 2016 Actual	31 March 2017 Budget	31 March 2017 Actual
CFR General Fund (£m)	224	218	218
CFR HRA (£m) (if applicable)	161	180	169
Total CFR	385	398	387

The movement in the HRA CFR is due in part from the budget being set for 2016/17 prior to the final year end position being known for 15/16. The 2016/17 HRA CFR was budgeted with an opening CFR of £166m and this was finalised at £161m. As explained in the 15/16 Annual Report as 'The HRA CFR has reduced by £6m and is attributable to an increase in income of over £2.4m as well as a reduction in capital spend of £3.5m'. There were additional asset sales of £6.5m during the 2016/17 financial year.

## 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	Date
PWLB	£5m	Fixed interest rate	2.49%	46 years	28/06/16
PWLB	£5m	Fixed interest rate	1.91%	49 years	18/08/16
PWLB	£5m	Fixed interest rate	1.91%	43 years	18/08/16
PWLB	£5m	Fixed interest rate	1.88%	49 years	30/08/16

**Repayment** – the following loans were repaid during the year: -

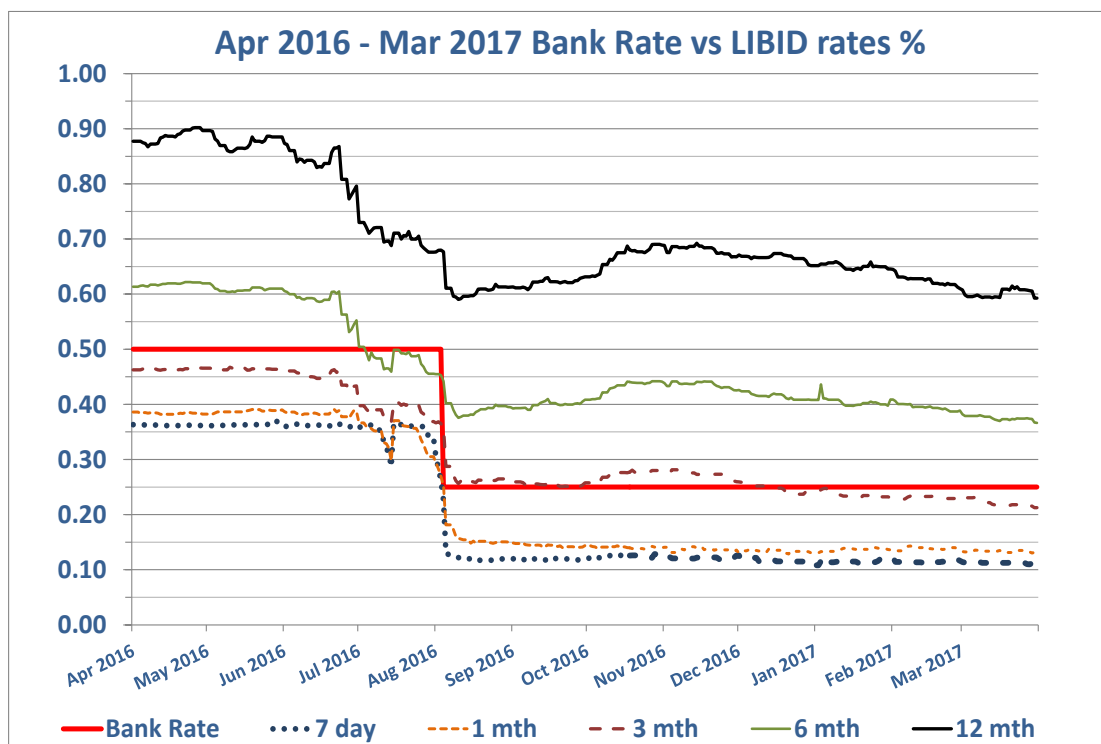
Lender	Principal	Type	Interest Rate	Maturity	Date
PWLB	£5m	Fixed interest rate	3.48%	7 years	24/09/16
PWLB	£0.662m	Fixed interest rate	8.625%	22 years	03/12/16
Kensington & Chelsea	£5m	Fixed interest Rate	0.6%	6 months	29/09/16

### 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.

## 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 Scottish Government investment regulations which have been implemented in the annual investment strategy approved by the Council on 23/02/16. 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 had minimal investment balances during the year as it sought to minimise its debt costs i.e. the Council temporarily used its reserves instead of external borrowing during 2016/17. It did, however, have the following loans to third parties which fall within the scope of the Councils Approved Investment Strategy:

Loan	Balance at 31/3/17
East Lothian Housing Association	£9.651m
Dunbar Fisherman’s Association	£0.020m



**Investments held by fund managers** – the Council uses Investec external fund managers to invest part cash balances on behalf of the four Common Good funds and ELC Charitable Trusts. The performance of the managers against the benchmark return was:

Fund Manager	Investments Held 31 March 16	Investments Held 31 March 17	Return	Benchmark*
Common Good	£2.849m	£3.363m	22.2%	20.2 %
Charitable Trust	£2.807m	£3.289m	21.3%	20.2 %
<b>Total</b>	<b>£5.656m</b>	<b>£6.652m</b>	<b>£0.996m</b>	

## Appendix 1: Prudential and treasury indicators

1. PRUDENTIAL INDICATORS	2015/16	2016/17	2016/17
<b>Extract from budget and rent setting report</b>	<b>actual</b>	<b>original</b>	<b>actual</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
<b>Capital Expenditure</b>			
Non - HRA	£31,268	£23,555	£23,343
HRA (applies only to housing authorities)	£22,020	£22,509	£18,559
<b>TOTAL</b>	<b>£53,288</b>	<b>£46,064</b>	<b>£41,902</b>
<b>Ratio of financing costs to net revenue stream</b>			
Non - HRA	8.11%	8.09%	8.53%
HRA (applies only to housing authorities)	33.21%	33.46%	33.77%
<b>Borrowing requirement General Fund</b>			
brought forward 1 April	£219,841	£223,694	£223,694
carried forward 31 March	£223,694	£218,162	£217,559
in year borrowing requirement	£3,853	£(4,712)	£(6,135)
<b>Borrowing requirement HRA</b>			
brought forward 1 April	£148,354	£161,364	£161,364
carried forward 31 March	£161,364	£180,346	£169,092
in year borrowing requirement	£13,010	£14,263	£7,728
<b>Total Borrowing Requirement</b>			
Non – HRA	£223,694	£218,162	£217,559
HRA	£161,364	£180,346	£169,092
<b>TOTAL</b>	<b>£385,058</b>	<b>£398,506</b>	<b>£386,651</b>
<b>Annual change in Cap. Financing Requirement</b>			
Non – HRA	£3,853	£(4,712)	£(6,135)
HRA	£13,010	£14,263	£7,728
<b>TOTAL</b>	<b>£16,863</b>	<b>£9,551</b>	<b>£1,593</b>
<b>Incremental impact of capital investment decisions</b>	<b>£ p</b>	<b>£ p</b>	<b>£ p</b>
Increase in council tax (band D) per annum *	£(3.59)	£15.69	£12.21
Increase in average housing rent per week	£2.33	£2.51	£1.46

<b>2. TREASURY MANAGEMENT INDICATORS</b>	<b>2015/16</b>	<b>2016/17</b>	<b>2016/17</b>
	<b>actual</b>	<b>original</b>	<b>actual</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
<b>Authorised Limit for external debt -</b>			
borrowing	£409,000	£419,000	£419,000
other long term liabilities	£52,000	£51,000	£51,000
TOTAL	£461,000	£470,000	£470,000
<b>Operational Boundary for external debt -</b>			
borrowing	£388,957	£398,508	£398,508
other long term liabilities	£42,490	£41,306	£41,306
TOTAL	£431,447	£439,814	£439,814
<b>Actual external debt (excludes PPP)</b>	£337,160	£379,297	£344,247
<b>Gross debt (includes PPP and Finance leases)</b>	£387,976	£439,814	£385,565
<b>Upper limit for fixed interest rate exposure</b>			
Net principal re fixed rate borrowing / investments	100 %	100 %	100%
<b>Upper limit for variable rate exposure</b>			
Net principal re variable rate borrowing / investments	30 %	30%	30 %
<b>Upper limit for total principal sums invested for over 364 days</b>	£30,000	£30,000	£30,000

The maturity structure of the debt portfolio was as follows:

	31 March 2016 actual	31 March 2017 actual
Under 12 months	£20.35m	£16,11m
12 months and within 24 months	£8.18m	£17.57m
24 months and within 5 years	£52.41m	£55,64m
5 years and within 10 years	£52,41m	£44.35m
10 years and within 15 years	£31.86m	£31.56m
15 years and within 20 years	£30.81m	£20.53m
20 years and within 25 years	£5.00m	£5.00m
25 years and within 30 years	£0m	£5.90m
30 years and within 35 years	£5.90m	£0m
35 years and within 40 years	£58.00m	£73.00m
40 years and within 45 years	£23.50m	£18.50m
45 years and over	£53.90m	£63.90m

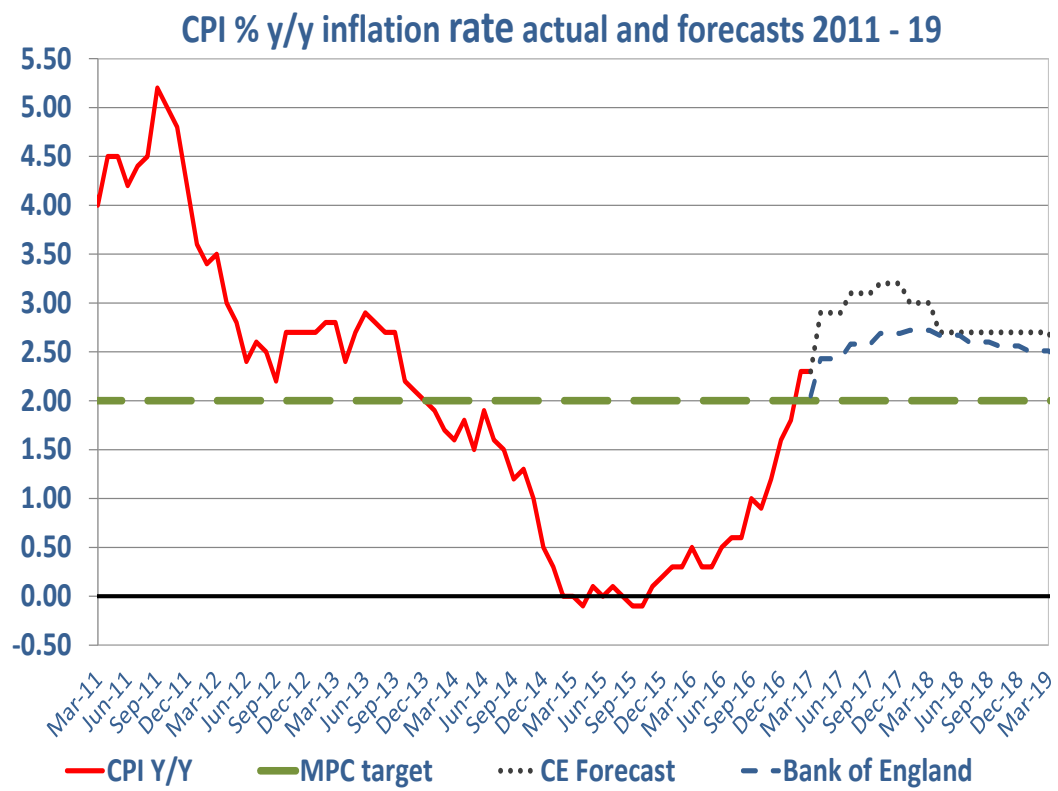
Maturity structure of fixed rate borrowing during 2016/17	upper limit	lower limit
under 12 months	20%	0%
12 months and within 24 months	30%	0%
24 months and within 5 years	40%	0%
5 years and within 10 years	40%	0%
10 years and over	75%	0%

Loans Fund (£m)	31 March 2016 Actual	31 March 2017 Budget	31 March 2017 Actual
Opening balance	£368	£389	£385
Add advances	£29	£24	£16
Less repayments	£13	£14	£14
Closing balance	£384	£399	<b>£387</b>

Loans Fund Non-HRA (£m)	31 March 2016 Actual	31 March 2017 Budget	31 March 2017 Actual
Opening balance	£220	£223	£224
Add advances	£13	£7	£5
Less repayments	£10	£11	£11
Closing balance	£223	£219	<b>£218</b>

Loans Fund (£m)	31 March 2016 Actual	31 March 2017 Budget	31 March 2017 Actual
Opening balance	£148	£166	£161
Add advances	£16	£17	£11
Less repayments	£3	£3	£3
Closing balance	£161	£180	<b>£169</b>

## Appendix 2: Graphs



	1	1-1.5	2.5-3	3.5-4	4.5-5	9.5-10	24.5-25	49.5-50	1 month variable
1/4/16	1.130%	1.160%	1.330%	1.470%	1.620%	2.310%	3.140%	2.950%	1.310%
31/3/17	0.830%	0.860%	0.990%	1.110%	1.240%	1.600%	1.800%	2.070%	1.010%
High	1.200%	1.250%	1.460%	1.630%	1.800%	2.510%	3.280%	3.080%	1.350%
Low	0.760%	0.800%	0.840%	0.880%	0.950%	1.420%	2.080%	1.870%	1.040%
Average	0.928%	0.961%	1.104%	1.226%	1.361%	2.007%	2.724%	2.494%	1.150%
Spread	0.440%	0.450%	0.620%	0.750%	0.850%	1.090%	1.200%	1.210%	0.310%
High date	27/04/2016	27/04/2016	27/04/2016	27/04/2016	27/04/2016	27/04/2016	27/04/2016	27/04/2016	20/05/2016
Low date	20/12/2016	15/03/2017	10/08/2016	10/08/2016	10/08/2016	10/08/2016	12/08/2016	30/08/2016	30/11/2016

	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%	1.60%	1.80%	2.07%
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%

### Money market investment rates 2016/17

	7 day	1 month	3 month	6 month	1 year
1/4/16	0.363	0.386	0.463	0.614	0.877
31/3/17	0.111	0.132	0.212	0.366	0.593
High	0.369	0.391	0.467	0.622	0.902
Low	<u>0.107</u>	<u>0.129</u>	<u>0.212</u>	<u>0.366</u>	<u>0.590</u>
Average	<u>0.200</u>	<u>0.220</u>	<u>0.315</u>	<u>0.462</u>	<u>0.702</u>
Spread	0.262	0.262	0.255	0.256	0.312
High date	27/5/16	21/6/16	10/5/16	22/4/16	26/4/16
Low date	28/12/16	21/12/16	30/3/17	31/3/17	10/8/16

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