



Name of meeting: Corporate Governance and Audit Committee 12 May 2017
 Cabinet 30 May 2017
 Council (date to be confirmed)

Title of report: Annual Report on Treasury Management 2016-17

Purpose of report

Financial Procedure Rules require that the Council receives an annual report on Treasury Management activities for the previous financial year. The report reviews borrowing and investment performance.

Key Decision - Is it likely to result in spending or saving £250k or more, or to have a significant effect on two or more electoral wards?	Not applicable
Key Decision - Is it in the Council's Forward Plan (key decisions and private reports) ?	Yes 29 March 2017
The Decision - Is it eligible for "call in" by Scrutiny?	Yes
Date signed off by Director & name	27 April 2017 Debbie Hogg
Is it also signed off by the Service Director for Finance, IT and Transactional Services?	Yes As above
Is it also signed off by the Service Director for Governance and Commissioning Support?	Yes, 28 April 2017
Cabinet member portfolio	Cllr Graham Turner

Electoral wards affected: Not applicable

Ward councillors consulted: Not applicable

Public or private: Public

1. Summary

1.1 The Council's treasury management operation for the year has followed the strategy approved by Council on 17 February 2016. Investments averaged £41.8 million, were largely deposited in instant access accounts and earned an average interest rate of 0.37%. Total external borrowing increased for the year by £13.3 million to £437.7 million. The increase is largely arising out of the need to replace balances spent. The majority of borrowing is on fixed rate terms and the average borrowing rate for 2016/17 was 4.78%.

- 1.2 The treasury management function spent £10.9 million on interest payments/received and £12.6 million on providing for the repayment of debt. There was a £11.6 million underspend against the budget, largely arising from the change in policy on Minimum Revenue Provision approved by Council on 15 February 2017. The Council complied with its treasury management prudential indicators, but did unintentionally breach the limits on amounts to be held with counterparties on three occasions due to circumstances explained in 2.8.2 and 2.8.3.

2. Information required to take a decision

2.1 Background

- 2.1.1 The Council has adopted the CIPFA Code of Practice on Treasury Management and operates its treasury management service in compliance with this Code and various statutory requirements. These require that the prime objective of the activity is to secure the effective management of risk, and that borrowing is undertaken on a prudent, affordable and sustainable basis.

- 2.1.2 Financial Procedure Rules require that the Council receives a report on Treasury Management activities for the previous financial year. Cabinet is responsible for the implementation and monitoring of the treasury management policies. Corporate Governance and Audit Committee undertake a scrutiny role with regard to treasury management.

- 2.1.3 In reviewing performance, reference will be made to the Treasury Management Strategy Report approved by Council on 17 February 2016.

2.2 Borrowing and Investment Strategy 2016/17

- 2.2.1 With the continuation of instabilities in the financial markets and fragility of economic activity, the over-riding policy was one of ensuring the security of the Council's balances. The Council chose to invest externally balances of around £30 million, largely for the purpose of managing day-to-day cash flow requirements, with any remaining balances invested "internally", offsetting borrowing requirements. The investment strategy was designed to minimise risk, investments being made primarily in instant access accounts or short-term deposits, with the major British owned banks and building societies, or Money Market Funds.

- 2.2.2 It was expected that the Council's external borrowing would increase by up to £30 million, arising mainly from the need to replace balances used. With short-term rates forecast to stay low over the next three years, it is proposed that new borrowing be kept to relatively short periods (up to 10 years).

2.3 The economy and interest rates

2.3.1 Politically, 2016/17 was an extraordinary twelve months which defied expectations when the UK voted to leave the EU and Donald Trump became President of the USA. Uncertainty arising from these outcomes and the slowdown of the Chinese economy in early 2016 all resulted in significant market volatility during the year.

2.3.2 The referendum result caused a sharp fall in the Sterling exchange rate and initial falls in interest rates and equity prices. Higher import prices, together with higher energy prices, resulted in CPI rising to 2.3% year/year in March 2017. Repercussions on economic growth were judged by the Bank of England to be sufficiently severe to prompt a cut in Base Rate to 0.25% in August and embark on further gilt and corporate bond purchases. Despite growth forecasts being downgraded, economic activity was fairly buoyant and the labour market also proved resilient. The UK's sovereignty rating was downgraded to AA by two of credit rating agency.

2.3.3 At the beginning of each quarter, interest rates for the UK were as follows:

		<u>Base rate</u>	<u>50 year PWLB (maturity)*</u>
2016	Apr	0.50%	2.95%
	Jul	0.50%	2.17%
	Oct	0.25%	2.17%
	Jan	0.25%	2.50%
2017	Apr	0.25%	2.34%
*Includes the 0.20% discount that the Council can access as part of the "certainty rate" scheme.			

2.4 Investment activity

2.4.1 The Council's treasury management investments totalled £31.3 million as at 31 March 2017 (£38.3 million 31 March 2016). The Council invested an average balance of £41.8 million externally during the year (£59.0 million 2015/16). Income of £0.153 million was generated through these investments (£0.264 million 2015/16). Appendix 1 shows where investments were held at the beginning of April, the end of September and the end of March, by counterparty, by sector and by country. The Council's average lending rate for the year was 0.37% (0.45% 2015/16), being above the weighted average 7 day London Interbank borrowing rate of 0.33%. The fall in rates between the years reflects the Base Rate cut in August.

2.4.2 The majority of investments were placed in instant access bank deposit accounts/Money Market Funds (MMFs). MMFs offer greater diversification of counterparties and thus lower risk, as well instant access and relatively good returns.

2.4.3 At the end of November, the Bank of England released the results of its latest stress tests on the seven largest UK banks and building societies (Barclays, HSBC, Lloyds/Bank of Scotland, Santander UK, HSBC, RBS/NatWest and Nationwide BS). The 2016 stress tests were more

challenging and designed under a new Bank of England framework, which tested the banks' resilience. No banks failed the test, but Royal Bank of Scotland, Barclays and Standard Chartered Bank were found to be the weakest performers. It should be noted that the tests were based on banks financials as at 31 December 2015 (11 months out of date), but our advisors, Arlingclose, regularly undertake analysis of relevant ratios in order to keep its clients informed of current bank creditworthiness.

2.5 Borrowing requirement and debt management

2.5.1 In terms of borrowing, long-term loans at the end of the year totalled £400.5 million and short-term loans (excluding interest accrued) £37.7 million (£408.4 million and £16.0 million 31 March 2016), an overall increase of £13.8 million. The only new long-term borrowing in the year was an interest free loan for £109k from West York Combined Authority, linked to a housing development scheme being undertaken by the Council. Appendix 2 details repayments of long-term loans during the year and short-term loans outstanding as at 31 March 2017.

	Actual £m
Decrease in Capital Financing Requirement excluding PFI	-4.7
Decrease in net balances	17.8
Increase in external borrowing and deferred liabilities	13.1

The Capital Financing Requirement (CFR) is the authority's underlying need to borrow for a capital purpose.

2.5.2 Fixed rate loans account for 82.5% of total long-term debt giving the Council stability in its interest costs. The maturity profile for fixed rate long-term loans is shown in Appendix 3 and shows that no more than 11% of fixed rate debt is due to be repaid in any one year. This is good practice as it reduces the Council's exposure to a substantial borrowing requirement in future years when interest rates might be at a relatively high level.

2.5.3 The primary source of the Council's borrowing is from the Government ie Public Works Loan Board (PWLB). In January 2015, DCLG announced that the PWLB would be abolished. It is likely that Treasury will take over the PWLB's responsibilities and lending arrangements will remain unaffected.

2.5.4 In June 2016, the Council received deed polls from Barclays Bank stating that it would not exercise its options to increase interest rates on £30 million of LOBO (Lender's Option, Borrower's Option) loans held by the Council. This effectively makes the loans fixed rate maturity loans. The interest rates on these loans range from 3.81% to 4.10%. This effectively brings the total of LOBO loans down to 76.6 million which represents 17.5% of total external borrowing. LOBO loans are when the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to

either accept the new rate or to repay the loan at no additional cost. No options were exercised during the year.

2.5.5 The Local Capital Finance Company established in 2014 by the Local Government Association as an alternative source of local authority finance. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. It has yet to issue any loans but officers will continue to monitor developments of this potential new funding source.

2.5.6 In terms of debt rescheduling, the premium charge for early repayment of PWLB debt remained relatively expensive for the loans in the Council's portfolio and therefore unattractive for debt rescheduling activity.

2.5.7 The average borrowing rate for 2016/17 was 4.78% (4.95% 2015/16).

2.6 Trends in treasury management activity

2.6.1 Appendix 4 shows the Council's borrowing and investment trends over the last 9 years. The analysis shows that at the onset of the "Credit Crunch" (2008), the Council was externally investing over £100 million, with average investment rates over 5%. From 2009/10 onwards as the banking crisis grew worse and investment rates fell, the Council adopted a policy of holding external investments for cash flow purposes only, initially at around £50 million and then further reduced to £30 million. Any further balances have effectively been "invested internally" to offset new borrowing requirements. For the first time in six years, the net debt position increased as the Council began to use its balances to support budget pressures.

2.6.2 The CFR for General Fund and HRA is currently £412.8 million and £186.2 million respectively. It is funded by external borrowing and balances internally invested.

2.7 Revenue Budget Monitoring

2.7.1 The outturn showed an under-spend of £11.6 million on a net spend of £23.6 million. The under-spend arose largely from the policy on debt repayment being modified (£8.0 million) and the decision to replace service revenue contributions to fund capital with borrowing (£1.8 million).

2.8 Risk and Compliance Issues

2.8.1 The Council can confirm that it has complied with its prudential indicators for 2016/17, which were approved as part of the Treasury Management Strategy. Details can be found in Appendix 5. Indicators relating to affordability and prudence are reported in the Capital Outturn report.

2.8.2 On two occasions (June and September) when the Council has received unexpected monies late in the day, officers have had no alternative but to put the monies into the Barclays Business Reserve

Account overnight. This led to a marginal breach of the investment limit on Barclays on each occasion (£553k and £733k), mainly because the Council was also investing with Barclays at the time, taking advantage of a preferential rate offered as a new current account customer. The offer ended in October and the Council has not invested with Barclays since then.

- 2.8.3 In addition at the end of April, a Barclays' software problem prevented the Council from transmitting funds to other counterparty deposit accounts. This caused the Council to have £11 million in excess of its own investment limit with Barclays over the weekend. The Council was compensated by Barclays for any loss of interest and the problem has not re-occurred.
- 2.8.4 In line with the strategy, the Council has not placed any direct investments in companies as defined by the Carbon Underground 200.
- 2.8.5 The Council is aware of the risks of passive management of the treasury portfolio and, with the support of the Council's consultants (Arlingclose), has proactively managed the debt and investments over the year.
- 2.8.6 The CIPFA Code of Practice requires that treasury management performance be subject to regular member scrutiny. The Corporate Governance and Audit Committee performs this role and members have received reports on strategy, half yearly monitoring and now the outturn for the year 2016/17. Training was provided to Members in March 2015 and consideration should be given to requesting Arlingclose to provide a refresh in the summer.

3. Implications for the Council

- 3.1 Early Intervention and Prevention (EIP) – no impact
- 3.2 Economic Resilience (ER) – no impact
- 3.3 Improving Outcomes for Children – no impact
- 3.4 Reducing demand of services - no impact
- 3.5 Other implications – Any changes in assumed borrowing requirements, balances and interest rates will be reflected in revenue budget monitoring reports during the year.

4. Consultees and their opinions

None.

5. Next steps

Report submitted to Council.

6. Officer recommendations and reasons

APPENDIX 1

Kirklees Council Investments 2016-17										
Counterparty	Credit Rating Mar 2017*	1 April 2016			30 September 2016			31 March 2017		
		£m	Interest Rate	Type of Investment	£m	Interest Rate	Type of Investment	£m	Interest Rate	Type of Investment
Specified Investments										
Bank of Scotland	Bank	F1/A+								
Svenka Handelsbanken	Bank	F1+/AA	2.9	0.45%	Instant Access	6.0	0.40%	Instant Access	1.3	0.20%
Std Life	MMF**	AAAmf	7.5	0.49%	Instant Access	7.5	0.37%	Instant Access	8.7	0.28%
Aviva	MMF**	Aaa-mf	7.3	0.48%	Instant Access	8.6	0.31%	Instant Access	7.3	0.22%
Aviva - Govt	MMF**	Aaa-mf				1.5	0.17%	Instant Access		
Deutsche	MMF**	AAAmf	6.7	0.46%	Instant Access	6.2	0.32%	Instant Access	6.9	0.20%
Goldman Sachs	MMF**	AAAmf	6.0	0.44%	Instant Access	7.7	0.30%	Instant Access	7.1	0.20%
Santander UK	Bank	F1/A	5.0	0.65%	31 day notice	3.0	0.40%	31 day notice		
Non-specified investments										
Barclays***	Bank	F1/A	2.9	0.10%+0.40%	Instant Access	2.9	0.10%+0.40%	Instant Access		
			38.3			46.5			31.3	
Sector analysis										
Bank			£m	%age		£m	%age		£m	%age
Bank			10.8	28%		10.3	22%		1.3	4%
Building Society										
MMF**			27.5	72%		36.2	78%		30.0	96%
Local Authorities/Cent Govt										
			38.3	100%		46.5	100%		31.3	100%
Country analysis										
UK			£m	%age		£m	%age		£m	%age
UK			7.9	21%		7.9	17%		1.3	4%
Sweden			2.9	7%		2.4	5%			
MMF**			27.5	72%		36.2	78%		30.0	96%
			38.3	100%		46.5	100%		31.3	100%

*Fitch short/long term ratings, except Aviva MMF (highest Moody rating). See next page for key. ** MMF – Money Market Fund. These funds are domiciled in Ireland for tax reasons, but the funds are made up of numerous diverse investments with highly rated banks and other institutions. The credit risk is therefore spread over numerous countries, including the UK. The exception to this is the Aviva Government Liquidity Fund which invests directly in UK government securities and in short-term deposits secured on those securities.

Key – Fitch’s credit ratings:

		Long	Short	
Investment Grade	Extremely Strong	AAA	F1+	
		Very Strong		AA+
	AA			
	AA-			
	Strong	A+		F1
		A		
		A-		
	Adequate	BBB+		F2
		BBB		
BBB-		F3		
Speculative Grade	Speculative	BB+	B	
		BB		
		BB-		
	Very Speculative	B+		C
		B		
		B-		
	Vulnerable	CCC+		C
		CCC		
		CCC-		
CC				
C				
Defaulting	D	D		

Appendix 2

Long-term loans repaid and short-term loans outstanding 31 March 2017

Long-term loans repaid during 2016/17

	Amount £000s	Rate %	Date repaid
Repayments on maturity			
PWLB (468634)	9,225	11.0	1 Jul 16
PWLB (498418)	4,613	3.84	15 Mar 17
Repayments on annuity loans			
PWLB (496956)*	308	4.58	29 Sep 16
PWLB (496956)*	315	4.58	29 Mar 17
Total	14,461		

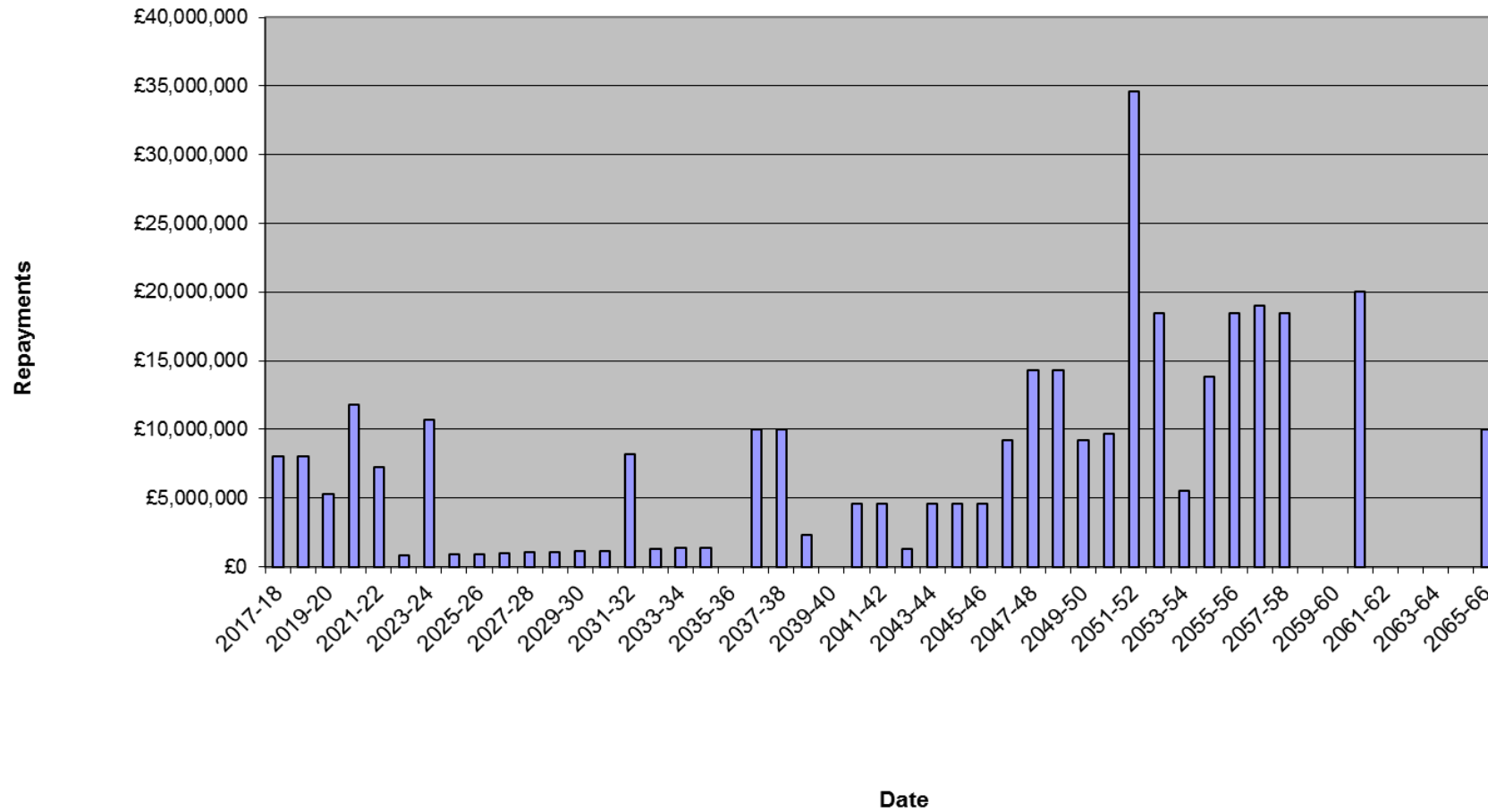
* represents loan extended to Kirklees College, for which the College is making similar repayments to the Council

Short-term loans outstanding 31 March 2017

	Amount £000s	Rate %	Length (days)
Temporary borrowing from the Money Market			
Police and Crime Commissioner Warwickshire	1,000	0.25	35
Leicester City Council	5,000	0.35	18
Halton Borough Council	10,000	0.25	14
Neath Port Talbot Council	5,000	0.25	10
Middlesbrough Council	7,500	0.30	11
Local lenders/Trust Funds	1,196		
Long-term loans due to mature in the next twelve months	8,032		
Total*	37,728		

* excludes interest accrued

KMC Loan Maturity Profile (Fixed-Rate)



Appendix 4

Kirklees Council - Borrowing and Investment Trends

At 31 March	2017	2016	2015	2014	2013	2012	2011	2010	2009
Investments	31.3m	38.3m	38.7m	33.1m	30.2m	19.3m	42.7m	38.7m	102.1m
ST Borrowing (excl interest accrued)	37.7m	16.0m	21.1m	29.6m	27.3m	30.6m	33.2m	18.6m	9.1m
LT Borrowing	400.5m	408.4m	422.6m	432.4m	452.1m	471.5m	527.1m	525.1m	528.4m
Total Borrowing	438.2m	424.4m	443.7m	462.0m	479.4m	502.1m	560.3m	543.1m	537.5m
Deferred liabilities (non PFI)	4.1m	4.3m	4.4m	4.5m	4.7m	4.8m	5.0m	5.1m	5.2m
Net debt position	411.0m	390.4m	409.4m	433.4m	453.9m	487.6m	522.6m	509.5m	440.6m
Capital Financing Requirement (excl PFI)									
General Fund	412.8m	411.3m	422.2m	447.5m	448.5m	458.6m	458.9m	435.9m	369.5m
HRA	186.2m	192.4m	196.6m	203.3m	209.3m	215.6m	242.4m	241.0m	241.0m
Total CFR	599.0m	603.7m	618.8m	650.8m	657.8m	674.2m	701.3m	676.9m	610.5m
Balances "internally invested"	156.7m	175.0m	170.7m	184.3m	173.7m	167.3m	136.0m	128.7m	67.8m
Ave Kirklees' investment rate for financial year	0.4%	0.5%	0.4%	0.4%	0.5%	0.6%	0.8%	1.5%	5.2%
Ave Base rate	0.3%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%
Ave LT Borrowing rate	2.5%	3.2%	3.7%	4.3%	4.1%	4.4%	5.3%	4.7%	4.6%

APPENDIX 5

Treasury Management Prudential Indicators

Interest Rate Exposures

While fixed rate borrowing can contribute significantly to reducing the uncertainty surrounding future interest rate scenarios, the pursuit of optimum performance justifies retaining a degree of flexibility through the use of variable interest rates on at least part of the treasury management portfolio. The Prudential Code requires the setting of upper limits for both variable rate and fixed interest rate exposure:

	Limit Set 2016-17	Actual 2016-17
Interest at fixed rates as a percentage of net interest payments	60% - 100%	83%
Interest at variable rates as a percentage of net interest payments	0% - 40%	17%

The interest payments were within the limits set.

Maturity Structure of Borrowing

This indicator is designed to prevent the Council having large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates.

Amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate	Limit Set 2016-17	Actual Levels 2016-17
Under 12 months	0% - 20%	0% - 5%
12 months to 2 years	0% - 20%	2% - 3%
2 years to 5 years	0% - 60%	5% - 8%
5 years to 10 years	0% - 80%	5% - 7%
More than 10 years	20% - 100%	80% - 84%

The limits on the proportion of fixed rate debt were adhered to.

Total principal sums invested for periods longer than 364 days

The Council has not invested any sums longer than 364 days.