

RHONDDA CYNON TAF COUNTY BOROUGH COUNCIL

MUNICIPAL YEAR 2017-2018

**COMMITTEE:
FINANCE AND PERFORMANCE
SCRUTINY COMMITTEE**

AGENDA ITEM NO. 4
2016/17 TREASURY MANAGEMENT REVIEW

4th October, 2017

REPORT OF :

THE GROUP DIRECTOR, CORPORATE AND FRONTLINE SERVICES

Chris Lee (01443) 424026

1.0 PURPOSE OF REPORT

1.1 This report provides Members with the opportunity to scrutinise the Annual Treasury Management Review presented to Council on 19th July 2017 (Appendix 1).

2.0 RECOMMENDATIONS

It is recommended that Members:

2.1 Scrutinise and comment on the information provided.

2.2 Consider whether they wish to receive further detail on any matters contained in the report.

3.0 ANNUAL TREASURY MANAGEMENT REVIEW (Appendix 1)

3.1 This report details the activities undertaken by the Treasury Management function during 2016/17.

3.2 I would like to highlight key points as follows:

- The Council has complied with all relevant Codes of Practice, regulations and guidance (para 3.3).
- The PFI agreement for the Lifelong Learning Centre at Garth Olwg was terminated on 25th January 2017 (para 7.3).
- Net Capital Charges for the year were within budget (para 7.5).
- Compliance has been achieved in terms of all Prudential and Treasury indicators (para 8.1).
- The Council continues to adopt a low risk strategy in terms of investing and borrowing (paras 9.2 - 9.3).

4.0 CONCLUSION

4.1 This report, together with Appendix 1 provides Members with the opportunity to scrutinise the 2016/17 activities of Treasury Management.

RHONDDA CYNON TAF COUNTY BOROUGH COUNCIL

MUNICIPAL YEAR 2017-2018

**COMMITTEE:
COUNCIL**

19th July 2017

AGENDA ITEM NO.9
2016/17 ANNUAL TREASURY MANAGEMENT REVIEW

REPORT OF :

THE GROUP DIRECTOR, CORPORATE AND FRONTLINE SERVICES
Chris Lee (01443) 424026

1.0 PURPOSE OF REPORT

1.1 This report constitutes the statutory requirement to provide Members with information on :-

- the Council's Treasury Management activity during 2016/17; and
- the actual Prudential and Treasury Indicators for 2016/17.

2.0 RECOMMENDATIONS

2.1 It is recommended that Members note the content of the report.

3.0 INTRODUCTION

3.1 Treasury Management is defined as:

"The management of a local authority's cash flows, its borrowings and its investments, the management of the associated risks, and the pursuit of the optimum performance or return consistent with those risks".

3.2 This report meets the requirements of both the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities. The Council is required to comply with both Codes through Regulations issued under the Local Government Act 2003.

3.3 The primary requirements of the Codes are as follows:

- Creation and maintenance of a Treasury Management Policy;
- Creation and maintenance of Treasury Management Practices, which set out the manner in which the Council will seek to achieve stated policies and objectives;

- Approval by Council (by 31st March) of a Treasury Management Strategy Report (including Prudential and Treasury Indicators and an Investment Strategy) for the year ahead, an Annual Review Report of the previous year and a Mid Year Review; and
- Effective scrutiny of the Treasury Management function.

Rhondda Cynon Taf C.B.C. complies with these requirements and supplements this by including detail of our treasury activities and prudential indicators in the quarterly Council performance reports to Members.

3.4 During 2016/17, the Finance and Performance Scrutiny Committee has continued to scrutinise the Treasury Management function via quarterly performance reports and reviews of the strategy and mid year position.

3.5 This annual report will cover the following areas of treasury activity during 2016/17 :

- Treasury Management advisors;
- Economic background;
- Borrowing strategy;
- Borrowing activity and results;
- The estimated and actual treasury position and prudential indicators;
- Investment strategy; and
- Investment activity and results.

3.6 It should be noted that the accounting practice to be followed by the Council requires financial instruments in the accounts (debt, investments, etc) to be measured in a method compliant with International Financial Reporting Standards. The figures in this report are based on the principal amounts borrowed and invested and so may differ from those in the Council's Statement of Accounts.

4.0 TREASURY MANAGEMENT ADVISORS

4.1 The Council appointed Arlingclose as its Treasury Management Advisors during March 2014. The contract is for 3 years with an option to extend for up to a further 2 years. During 2016/17 the Council took the option to extend the contract up to 31st March 2019.

4.2 To date the service provided has been good. The Council will continue to monitor the advisor's performance. If any adverse performance or contractual issues arise, Members will be informed accordingly.

4.3 The Council recognises that although information and advice is provided via the contract, responsibility for Treasury Management decisions remains with the Council.

5.0 ECONOMIC BACKGROUND

5.1 General Economic Background

- 5.1.1 The UK voted to leave the European Union in June 2016 and this, together with the change of presidency in the US and the slowdown in the Chinese economy in the early part of 2016, resulted in significant market volatility during the year.
- 5.1.2 The sharp fall in the sterling exchange rate following the referendum had an impact on import prices which, together with rising energy prices, resulted in CPI rising from 0.3% at the beginning of the financial year to 2.3% in March 2017.
- 5.1.3 The outcome to the referendum subdued investor and business confidence and repercussions on economic growth were judged by the Bank of England to be sufficiently severe to prompt its Monetary Policy Committee to cut the Bank Rate to 0.25% in August 2016.
- 5.1.4 Despite growth forecasts being downgraded, economic activity was fairly buoyant and the UK's Gross Domestic Product (GDP) grew by 0.6%, 0.5% and 0.7% in the last three quarters of 2016.
- 5.1.5 The Council continued to maintain a low risk strategy throughout the year to ensure exposure to any capital loss was minimised.

5.2 Short term investment rates

- 5.2.1 The Council's investment income is subject to changes in short term interest rates. The level of the Bank Rate is one of the main determinants of the rate of interest the Council receives on its short term investments. The forward looking estimate of the Bank Rate, as provided by our Treasury Management advisors, is for the rate to remain at 0.25% throughout 2017/18 and into the foreseeable future.

5.3 Longer term interest rates

- 5.3.1 The majority of the Council's borrowing is from the PWLB (Public Works Loan Board). Long-term borrowing rates are influenced by gilt yields which are driven by inflation and demand/supply considerations.
- 5.3.2 During August 2012, HM Treasury introduced "the certainty rate", whereby local authorities are able to access borrowing at 0.2% cheaper than published PWLB rates. In order to access the discounted rate, authorities were required to provide Welsh Government (and onward, the Debt Management Office) with an indication of their potential borrowing requirements for the next 3 years.
- 5.3.3 PWLB rates during 2016/17 were as follows (these are the "certainty rates"):

	5 years	10 years	20 years	50 years
Average	1.43%	2.06%	2.67%	2.52%
Highest	1.88%	2.56%	3.22%	3.11%
Lowest	0.99%	1.46%	2.01%	1.90%

6.0 BORROWING STRATEGY

- 6.1 The borrowing strategy for 2016/17 approved by Council in March 2016 stated that the borrowing requirement to fund the 2016/17 Capital Programme was £44.4m. In line with the capital programme, the borrowing requirement decreased to £30.9m during the year largely due to the re-profiling of the 21st Century Schools schemes. It was also reported that the cheapest form of borrowing would be “internal borrowing” by running down cash balances and foregoing interest earned at historically low rates. This also minimises counterparty risk (risk that an investment may become irrecoverable).
- 6.2 The strategy also reported that the Section 151 Officer, under delegated powers, would take the most appropriate form of borrowing depending upon the prevailing interest rates at the time, taking into account advice provided by our advisors and an assessment of risk.
- 6.3 Affordability and the cost of carry remain important influences on the Council’s borrowing strategy. As short term interest rates have remained, and are likely to remain lower than longer term rates, short term cashflow shortfalls have been met by utilising short term loans.
- 6.4 In the 2016/17 strategy approved by Council in March 2016 it was also reported that the Council may reschedule debt where there is an opportunity to generate savings. However, changes in PWLB rate calculations have reduced the attractiveness of early repayments associated with rescheduling.

7.0 BORROWING ACTIVITY AND RESULTS

- 7.1 A summary of the Council’s borrowing activity (excluding Finance Leases) can be seen in the table below:

	Opening Balance 1st April 2016	Movement	Closing Balance 31st March 2017	Average Debt	Total Interest	Average Interest
	£M	£M	£M	£M	£M	%
PWLB	109.297	0	109.297	109.297	5.244	4.80
Banks LOBOS	31.000	0	31.000	31.000	1.395	4.50
Banks Fixed Term	56.500	0	56.500	56.500	2.937	5.20
Other	0.218	(0.145)	0.073	0.145	0	0.00
Local Authorities	0	35.000	35.000	5.003	0.018	0.36
Total	197.015	34.855	231.870	201.945	9.594	4.75

- 7.2 Short term loans were taken to meet day to day cashflow requirements at an average rate of 0.36% during the year. In accordance with our risk strategy as detailed in section 6 above, to minimise investment exposure and counterparty risk on cash balances held, no new long term borrowing was undertaken during 2016/17.
- 7.3 In December 2015, the Council determined to voluntarily terminate the PFI agreement for the Lifelong Learning Centre at Garth Olwg. A final termination notice was issued to the contractor on 28th July 2016 and the agreement terminated on 25th January 2017.
- 7.4 In line with the requirements of the Project Agreement, the Council was liable for the outstanding amounts of Senior Debt (Loan) and the costs of early breakage which became payable on the 26th January 2017. Council on the 16th December 2015 authorised the consequential borrowing to refinance the Centre.
- 7.5 During the year there was a net saving on the Council's Net Capital Charge Budget (£23.0m) of £0.145m. This has been achieved as a result of prudent and effective management of the Council's cash-flows (enabling delays to borrowing being taken), despite the challenges faced with investment income and maintaining our low risk strategy.
- 7.6 There were no opportunities to further reduce the cost of our borrowing via rescheduling during the year.
- 7.7 Members will also recall the previously reported position with regard to the accounting arrangements and treatment of LOBOs (Lender Option / Borrower Option). These loan instruments have enabled the Council to realise significant short-term and further ongoing reductions in its capital charges. These savings have been invested into key service improvements

and the Treasury Management Reserve, which have helped not only to reduce risk around future financial market changes, but also as pump priming to produce more efficient and effective on-going front line services for the taxpayer.

8.0 ESTIMATED AND ACTUAL TREASURY POSITION, PRUDENTIAL AND TREASURY INDICATORS

8.1 During the financial year 2016/17, the Council operated within its limits set out in the Prudential Code report approved in March 2016. Details of limits and actual performance are as follows:

		2016/17 Actual £
Capital Expenditure 16/17		83.763M
Capital Financing Requirement (CFR) as at 31 st March 2017		411.081M

Limit / Indicator	2016/17 Limit / Indicator	2016/17 Actual
Authorised Limit (£) (Limit beyond which borrowing is prohibited)	430.000M	232.447M (at highest point in year)
Operational Boundary (£) (Indicator to ensure Authorised Limit not breached)	276.000M	232.447M (at year end)
External Debt (£)	251.970M	231.870M
Other Long Term Liabilities	<u>0.900M</u>	<u>0.191M</u>
Sub total	252.870M	232.061M
Other : PFI and Finance Lease	<u>23.082M</u>	<u>0.386M</u>
Borrowing + Other Long Term Liabilities	275.952M	232.447M
Ratio of Financing Costs to Net Revenue Stream	4.62%	4.56%
Limit on Fixed Interest Rates	55% - 125%	90%

Limit on Variable Interest Rates	-25% - 45%	10%
Funds invested for greater than 1 year (£)	15M	6.1M
LOBO Limit	£100M / 45% of debt portfolio	£31M / 13% of debt portfolio
Maturity Structure of Fixed Rate Debt	Under 12 mths 0-60% 12 mths – 2 yrs 0-60% 2-5 years 0-60% 5-10 years 0-70% 10-20 years 0-90% 20-30 years 0-90% 30-40 years 0-90% 40-50 years 0-90%	Under 12 mths 26% 12 mths – 2 yrs 0% 2-5 years 0% 5-10 years 0% 10-20 years 1% 20-30 years 0% 30-40 years 70% 40-50 years 3%

9.0 **INVESTMENT STRATEGY**

- 9.1 The Council manages its investments in-house, investing during 2016/17 in line with the Council's approved lender criteria as approved by Council on the 23rd March 2016 and amended 20th July 2016. Investment policy is governed by Welsh Government guidance.
- 9.2 The Council's temporary cash flows are currently being invested in the Debt Management Account Deposit Facility and other Government backed public sector bodies. The Council supplements this strategy with lending to organisations subject to S151 officer determination, following appropriate due diligence and subject to appropriate and acceptable security arrangements. This low risk strategy was formed balancing risk and return. It is acknowledged that low risk investment strategies result in lower investment returns.
- 9.3 A number of AAA rated money market funds have been set up to provide further diversification options if the opportunity arises in the future. These accounts have not been used during 2016/17. Members will be kept informed of any changes as part of the Council's quarterly performance reports.
- 9.4 During the year, the Council has complied with the approved strategy and there have been no liquidity difficulties.
- 9.5 The funds invested for greater than one year relate to the commercial agreement with Trivallis (para.10.2) and the Local Authority Mortgage Scheme (para.11).

10.0 **INVESTMENT ACTIVITY AND RESULTS**

10.1 The following table shows the overall result of the investment activities undertaken by the Council:

	Interest Received	Average Cash Balance	Return on Investments	Benchmark Return
	£M	£M	%	%
Cash Balances	0.155	26.313	0.59	0.20

The benchmark return for Local Authority internally managed funds is the average 7-day LIBID rate.

10.2 Despite our low risk strategy our return on investments is above the benchmark return. The key contributory factors are the return on the £1M 5-year deposit with Lloyds in respect of the Local Authority Mortgage Scheme (see paragraph 11) and the commercially agreed 10 year loan of £5.125m with Trivallis (entered into on the 8th November 2016).

10.3 The Economic Background section of this report set out the continuing difficulties in economic conditions during this period. As a result of these conditions and our low risk strategy, interest rates on investments remain low.

11.0 **LOCAL AUTHORITY MORTGAGE SCHEME (LAMS)**

11.1 During September 2012, the Council launched the Local Authority Mortgage Scheme which supports first time buyers in purchasing a home. The scheme is facilitated by Lloyds Bank and allows first time buyers to access 95% loan to value mortgages on terms similar to 75% loan to value mortgages. The bank is able to offer such loans where the Council guarantees the loan up to 20% of the value of the property. It is a requirement of the scheme that the Council places a deposit with the bank for the length of the indemnity. Therefore the Council has a deposit of £1m with Lloyds for 5 years.

12.0 **CONCLUSION**

12.1 The last financial year has continued to be challenging in relation to Treasury Management and this report highlights for Members that all related activities have operated effectively and within budgetary and prudential limits.
