ARGYLL AND BUTE COUNCIL	**COUNCIL**
STRATEGIC FINANCE	**29 JUNE 2017**

ANNUAL TREASURY REPORT 2016-17

1. EXECUTIVE SUMMARY

1.1 This report outlines the Council's Treasury Management position for 2016-17.

1.2 The Council is required by regulations issued under the Local Government in Scotland Act 2003 to produce an annual review of treasury management activities and the actual prudential and treasury indicators and submit this to Council. The report at Appendix 1 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).

1.3 The key points to note from the annual report are:

- Reporting requirements under the Code were met during 2016-17.
- During 2016-17 the Council's External Borrowing Increased by £12.5m from £158.0m at 31 March 2016 to £170.5m at 31 March 2017. The increase was due to new borrowing from the Public Works Loans Board (PWLB) of £25.0m at historically low rates and an interest free loan of £0.4m from Salix in respect of the Street Lighting LED Project. This was offset by repayments of £8.9m to the PWLB and a reduction in temporary borrowing of £4.0m.
- The savings in loan charges were £0.944m in 2016-17 through delaying borrowing and an overall reduction in interest rates.
- The Capital Financing Requirement (excluding NPDO commitments) was £180m this is £9.5m higher that the Council's external debt. This difference has been financed by cash balances to reduce the interest payable as investment returns are considerably below the cost of new borrowing.
- Investments at 31 March 2017 were £64m at an average rate of 0.660% compared to £46m at an average rate of 0.782% for 31 March 2016.
- The average investment rate for 2016-17 was 0.639% compared to the average 7 day LIBID rate of 0.200%.The investments generated £0.636m of income.
- The Asset Management Fund was invested in an enhanced Money Market Fund during 2016-17 to increase the rate of return while future long term investment of the fund is being assessed. The return on the fund was £20,640 a rate of return of 0.597%.

1.4 This report meets the Code requirement for a treasury annual report. The Council remains under borrowed (around 5% of the CFR is not supported by borrowing) but current borrowing and investment rates mean additional costs would be incurred to address this.

2. RECOMMENDATIONS

2.1 The Treasury Management Annual Report is approved.

3. IMPLICATIONS

3.1 Policy – None

3.2 Legal – None

3.3 Human Resources – None

3.4 Financial – None

3.5 Equal Opportunities – None

3.6 Risk – None

3.7 Customer Service – None

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15 June 2017

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Appendix 1 – Annual Treasury Report 2016-17

Appendix 1

ANNUAL TREASURY REPORT

2016-2017

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 or the Policy and Resources Committee should receive the following reports:

- an annual treasury strategy in advance of the year (Council 11 February 2016)
- a mid-year (minimum) treasury update report (Policy and Resources Committee 15 December 2016)
- an annual review following the end of the year describing the activity compared to the strategy (this report).

In addition, the Policy and Resources Committee has received treasury management update reports on 18 August 2016, 27 October 2016, 16 February 2017 and 16 March 2017.

The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is 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 also confirms that it has complied with the requirement under the Code to give scrutiny to all of the above treasury management reports by the Performance Review and Scrutiny 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.

3. Overall Treasury Position as at 31 March 2017

At the beginning and the end of 2016/17 the Council's treasury (excluding borrowing by PFI and finance leases) position was as follows:

	31 March 2016 Principal	Rate/ Return	Average Life yrs	31 March 2017 Principal	Rate/ Return	Average Life yrs
Total debt	***£158m***	***5.5%***	***30.97***	***£171m***	***5.0%***	***33.7***
CFR	***£178m***			***£180m***		
Over / (under) borrowing	***(£20m)***			***(£9m)***		
Total investments	***£46m***	***0.8%***		***£64m***	***0.7%***	
Net debt	**£112m**			**£107m**		

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.

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.

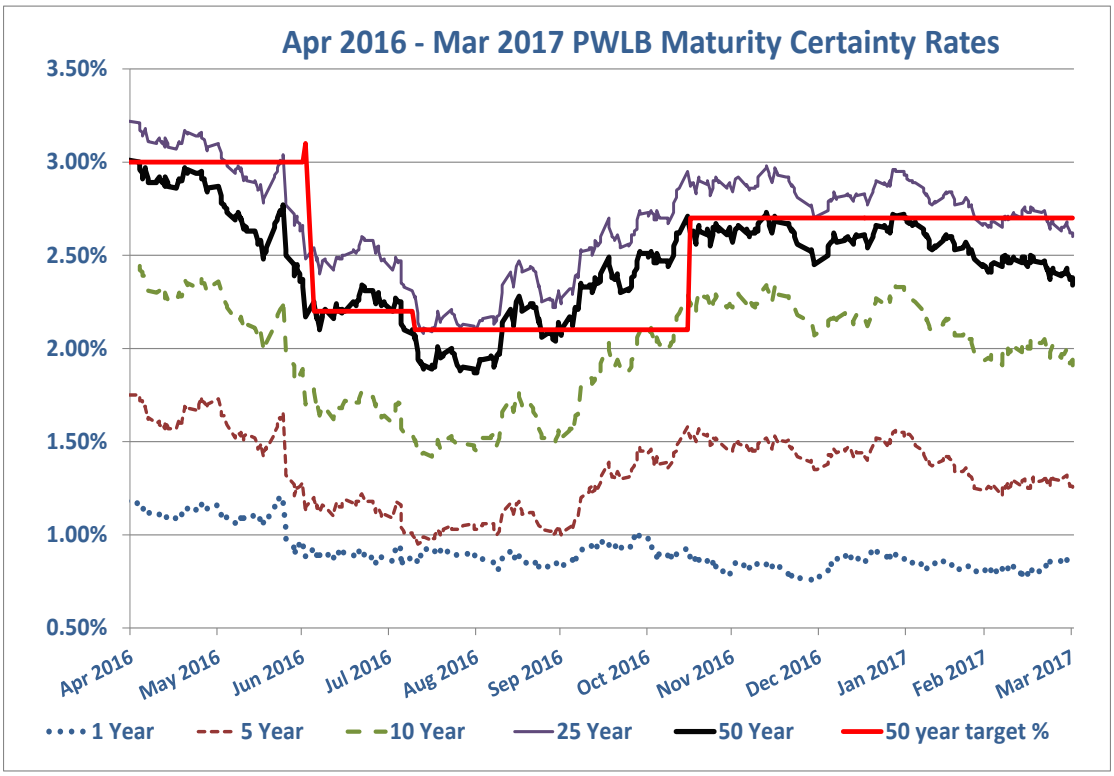
5. The Borrowing Requirement

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

	31st March 2016 Actuals £M	31st March 2017 Budget £M	31st March 2017 Actuals £M
CFR - General Fund	254	266	254
Less NPDO	76	74	74
Net CFR	178	192	180

6. Borrowing Rates in 2016/17

Public Works Loans Board (PWLB) certainty maturity borrowing rates - the graph below shows how PWLB certainty rates have fallen to historically very low levels during the year.



Borrowing Outturn for 2016/17

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

Lender	Principal	Type	Interest Rate	Maturity
PWLB	£10m	Fixed Interest Rate	2.71%	47 years
PWLB	£5m	Fixed Interest Rate	2.53%	48 Yrs 6 mths
PWLB	£5m	Fixed Interest Rate	1.87%	47 years
PWLB	£5m	Fixed Interest Rate	2.39%	50 years

Rescheduling

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

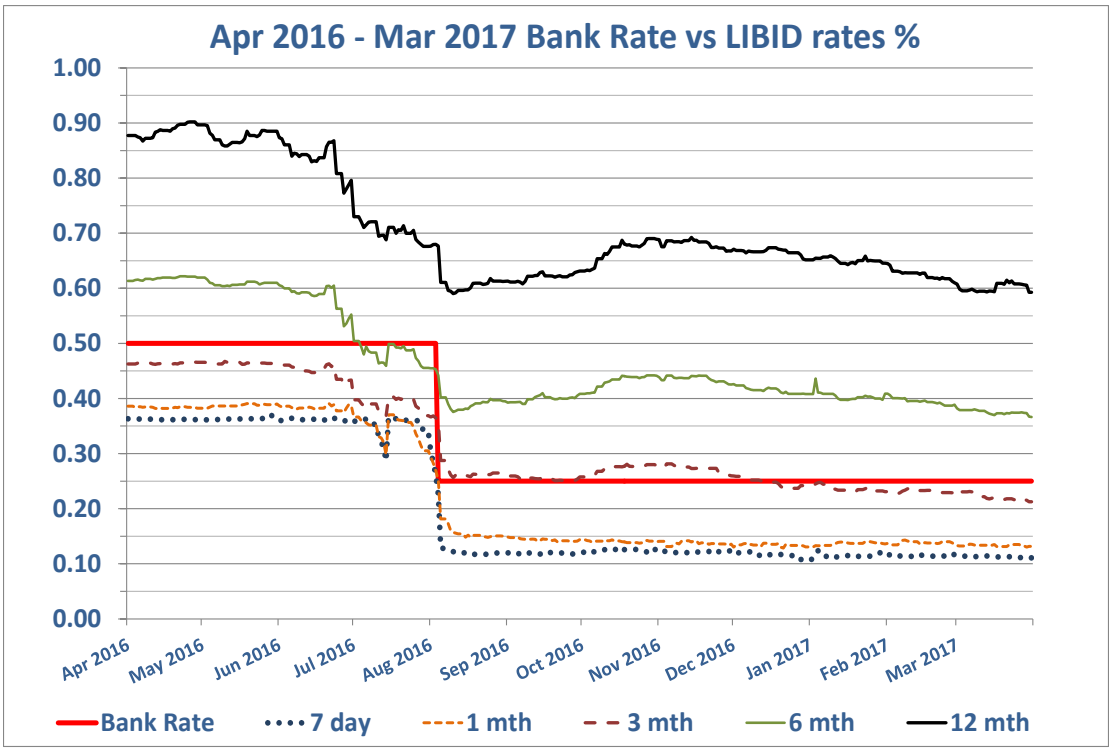
Repayments
The Council repaid the following long term loans during the year using investment balances.

Lender	Principal	Type	Interest Rate
PWLB	£0.34 m	Fixed Interest Rate	11.25%
PWLB	£0.27m	Fixed Interest Rate	11.13%
PWLB	£0.87m	Fixed Interest Rate	9.75%
PWLB	£2.41m	Fixed Interest Rate	9.50%
PWLB	£0.35m	Fixed Interest Rate	9.38%
PWLB	£0.52m	Fixed Interest Rate	9.38%
PWLB	£0.08m	Fixed Interest Rate	10.50%
PWLB	£0.18m	Fixed Interest Rate	10.50%
PWLB	£0.87m	Fixed Interest Rate	9.88%
PWLB	£3.0m	Fixed Interest Rate	3.59%

Summary of debt transactions
Management of the debt portfolio resulted in a decrease in the average interest rate of 0.5% due to an increase in long term borrowing, overall the reduction in interest payments resulted in net General Fund saving of £0.944m.

7. 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.



8. Investment Outturn 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 11/02/2016. 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 daily balance of £73.3m of internally managed funds. The internally managed funds earned an average rate of return of 0.639%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.200%. This generated £0.636m of interest in 2016/17.

Asset Management Fund – the Council invested the £1m Asset Management Fund in an enhanced Money Market Fund during 2016-17 to increase the rate of return while future long term investment of the fund is being assessed. The return on the fund was £20,640 a rate of return of 0.597%.

9. 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:

Actual prudential and treasury indicators	2015/16 Actual £000	2016/17 Original £000	2016/17 Actual £000
Capital expenditure	36,281	34,685	23,751
Capital Financing Requirement	256,079	265,766	253,896
Gross borrowing	247,280	243,648	244,557
External debt	158,090	169,589	170,503
Investments	46,438	20,000	63,722
Net borrowing	111,652	149,589	106,781

All investments were for less than one year.

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 (2015/16) plus the estimates of any additional capital financing requirement for the current (2016/17) 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 – this Council has kept within its authorised external borrowing limit as shown by the table above.

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.

	2016/17
Authorised limit	£303m
Maximum gross borrowing position	£246m
Operational boundary	£295m
Average gross borrowing position	£240m
Financing costs as a proportion of net revenue stream	7.8%

The maturity structure of the debt portfolio was as follows:

	31st March 2016 Actual	**2016/17 Original Limits**	**31st March 2017 Actual**
Under 12 months	£16.6m	£50.9m	£12.6m
12 months and within 24 months	£8.9m	£50.9m	£5.5m
24 months and within 5 years	£16.4m	£50.9m	£11.9m
5 years and within 10 years	£6.5m	£67.8m	£5.9m
10 years and within 20 years	£0.0m	£135.7m	£7.0m
20 years and within 30 years	£12.9m	£135.7m	£5.8m
30 years and within 40 years	£28.9m	£135.7m	£33.8m
40 years and within 50 years	£36.8m	£135.7m	£57m
50 years +	£31.0m	£135.7m	£31m
Total	£158.0m	£898.8m	£170.5m

The Council's exposure to fixed and variable interest rates in respect of borrowing was as follows which demonstrates that at the year-end the proportion of fixed and variable borrowing was within the agreed limits:

	31 March 2016 Actual	2016/17 Original Limits	31 March 2017 Actual
Fixed rate (principal or interest) based on net debt	100%	190%	119%
Variable rate (principal or interest) based on net debt	42%	60%	41%