

Appendix A

Treasury Management Annual Report 2016/17

Purpose of the report:

1. Under the CIPFA Code of Practice on Treasury Management (the Code) the Section 151 Officer is required to produce an outturn report on activities in the year to account for how the Strategy set at the start of the year has been implemented. This report meets the requirements of both the Code and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

Background

2. The Council's treasury management activity is underpinned by CIPFA's Code of Practice on Treasury Management (the Code), which requires local authorities to produce annually Prudential Indicators and a Treasury Management Strategy Statement on the likely financing and investment activity. The Code also requires reports to full Council mid-year and after the year end.
3. The Code also requires the Council to nominate one of its Committees to have responsibility for scrutiny of its treasury management strategy, policy and activity. Council has delegated this responsibility to the Overview and Scrutiny Management Board and Audit Committee. Overall responsibility for treasury management remains with the Council. No treasury management activity is without risk; the effective identification and management of risk are integral to the Council's treasury management objectives.
4. Treasury management is defined as:

"The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

The Economy and Interest Rates for 2016/17

5. The two major landmark events that had a significant influence on financial markets in the 2016/17 were the UK EU referendum on 23 June and the election of President Trump in the USA presidential elections 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 the Bank Rate from 0.50% 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, and introduced the "Term Funding Scheme" whereby 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 increased to produce an annual growth of +1.8%, which was nearly the fastest rate of growth of any of the G7 countries.

This meant that the MPC did not cut Bank Rate again after August. Since then, inflation has risen due to the effects of the sharp devaluation of sterling after the referendum. By the end of March 2017, sterling was 17% down against the dollar but had not fallen as far against the euro.

In February 2017, the latest CPI inflation figure had risen to 2.3%, above the MPC's inflation target of 2%. However, the MPC's view was that it would discount near term supply side driven inflation, (i.e. not raise Bank Rate), caused by sterling's devaluation, despite forecasting that inflation would reach nearly 3% during 2017 and 2018. This outlook, however, is dependent on domestically generated inflation, (i.e. wage inflation), continuing to remain subdued despite the fact that unemployment is at historically very low levels and is on a downward trend. Market expectations for the first increase in Bank Rate moved forward to quarter 3 2018 in response to increasing concerns around inflation.

6. USA. Quarterly growth in the US has been very volatile during 2016 but a strong performance since mid-2016, and rising inflation, prompted the Federal Reserve into raising rates in December 2016 and March 2017. The US is the first major western country to start on a progressive rise in rates. Overall growth in 2016 was 1.6%.
7. EU. The EU is furthest away from an upswing in rates; the European Central Bank (ECB) has cut rates into negative territory, provided large tranches of "cheap" financing and carrying out major quantitative easing purchases of debt during the year to boost growth and to get inflation up from near zero towards its target of 2%. These purchases have resulted in depressed bond yields in the EU, but, towards the end of 2016, yields rose, probably due at least in part to rising political concerns around the positive prospects for populist parties and impending general elections in 2017 in the Netherlands, France and Germany. The action taken by the ECB has resulted in economic growth improving in the eurozone to an overall figure of 1.7% for 2016, with Germany achieving a rate of 1.9% as the fastest growing G7 country.
8. President Trump's election and promise of fiscal stimulus, which are likely to increase growth and inflationary pressures in the US, have resulted in US Treasury yields rising sharply. Gilt yields in the UK have been caught between these two influences and the result is that the gap in yield between US treasuries and UK gilts has widened during 2016/17 due to market perceptions that the UK is still likely to be two years behind the US in starting on an upward trend in rates despite four years of strong growth.
9. China and emerging market counties. At the start of 2016, there were considerable fears that China's economic growth could be heading towards a hard landing, which could destabilise some emerging market countries particularly exposed to a Chinese economic slowdown and / or to the effects of a major reduction in revenue from low oil prices. These fears have largely subsided and oil prices have partially recovered so, overall, world growth prospects have improved during the year.

10. Equity markets. The result of the referendum, and the consequent devaluation of sterling, boosted the shares of many FTSE 100 companies which had major earnings which were not denominated in sterling. The overall trend since then has been upwards and received further momentum after Donald Trump was elected President as he had promised a major fiscal stimulus to boost the US economy and growth rate.

Treasury position as at 31 March 2017

11. The table below indicates the balance of borrowing and investments at the beginning and end of the year:

	31 March 2016		31 March 2017	
	£m	Rate %	£m	Rate %
Long Term Debt (fixed rates) - PWLB	292	5.09	311	5.09
Long Term Debt (fixed rates) – LOBOS	120	4.07	100	4.14
Long Term Debt (fixed rates) – Market	3	6.88	23	4.24
Short Term Borrowing	2	0.55	-	-
Total borrowing	417	4.81	434	4.81
Investments	146	0.63	70	0.57
Net Borrowing Position	271		364	

12. In June 2016, Barclays Bank removed their options inherent within two LOBO loans amounting to £20m at no cost to the authority. These loans are now classed as market loans with their rates remaining fixed until maturity reducing the interest rate / re-financing risk of the authority.

13. The total borrowing excludes accrued interest of £5m (£5m at 31/3/16) and the outstanding finance on PFI and service contracts of £146m at 31 March 2017 (£152m at 31/3/16).

14. During the year, the authority as planned, borrowed £19.2m from the PWLB on the 31st March 2017 at a preferential rate for the Bristol Temple Meads East Regeneration (Arena) scheme reducing the interest rate risk and liquidity risk exposed to the authority.

15. The authority also has long term service investments costing £18.45m primarily relating to the equity investments in Bristol Holdings Company (£15.95m) and the Bristol Port Company (£2.5m). In addition the authority recently invested £5m in a long term treasury investment in a property fund to support Homelessness.

16. The Net debt has increased by £93m from £271m to £364m primarily due to;

- Funding of the capital programme financed by borrowing (£67m)
- Application / use of Reserves (£41m)
- Other changes to working capital / provisions +£15m

Long Term Borrowing – Strategy and outturn

17. The 2016–2019 Treasury Strategy (approved 16th February 2016) identified a medium term

borrowing requirement of £150m to support the existing and future Capital Programme with the debt servicing costs predominately met from revenue savings from capital investment and the economic development fund. The £150m was planned to be borrowed equally in 2016/17 (£75m) and 2017/18 (£75m).

18. The Council's Strategy is also to defer borrowing while it has significant levels of cash balances (£70m at March 2017 and £146m at March 2016). Deferring borrowing will reduce the "net" revenue interest cost of the Authority as well as reducing the Council's exposure to counter party risk for its investments. The Council recognises that utilising investments in lieu of borrowing clearly has a finite duration and that future borrowing will be required to support capital expenditure (see 2016/17 Treasury Management Strategy approved by Council 16th February 2016).

https://democracy.bristol.gov.uk/Data/Full%20Council/201602161400/Agenda/0216_5.pdf

19. Borrowing activity in year was in accordance with the Strategy approved at the beginning of the year:

- **Borrowing** – The authority, as planned, borrowed £19.2m from the PWLB on the 31st March 2017 at a preferential rate for the Bristol Temple Meads East Regeneration (Arena) scheme reducing the interest rate risk and liquidity risk exposed to the authority. No further borrowing was undertaken, as the authority maintained higher levels of investments than originally anticipated for a variety of reasons including the time taken to progress capital schemes where the source of financing is external borrowing.
- **Rescheduling** – No debt rescheduling activity was undertaken in 2016/17. As set out in the Treasury Mid-Year report the total life cycle cost of rescheduling loans on a discounted cash-flow basis has been reviewed with no loans providing a positive cash-flow benefit to the authority. This would in part be due to large early repayment penalties that the authority will incur, circa £261m penalty to repay the PWLB loans (£311m) early as at 31st March 2017.
- **Repayment** – A short term loan (£2m for 1 day) was repaid on the 1st April 2016.

Annual Investment Strategy and Outturn

20. 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.
21. Deposit rates continued into the start of 2016/17 at previous depressed levels falling 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 back at the end of the year.
22. Security of capital remained the Council's main investment objective. This was maintained by following the Council's policy for assessing institutions to which the council might lend. 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.).

23. Investments held by the Council - the Council maintained an average balance of £146m (£245m 2015/16) of internally managed funds. The internally managed funds received an average return of 0.57% (0.63% 2015/16). The comparable performance indicator is the average 7-day LIBID rate, which was 0.20%.

Compliance with Treasury Limits and Treasury Related Prudential Indicators

24. The Council can confirm that:

- All treasury related transactions were undertaken by authorised officers and within the limits and parameters approved by the Council;
- All investments were to counterparties on the approved lending list
- The Council operated within the Prudential Indicators within Appendix 1.

Performance Indicators set for 2016/17

25. One of the key requirements in the Code is the formal introduction of performance measurement relating to investments, debt, and capital financing activities. Whilst investment performance criteria have been well developed and universally accepted, debt performance indicators continue to be a more problematic area with the traditional average portfolio rate of interest acting as the main guide. The Council's performance indicators were set out in the Annual Treasury Management Strategy.

26. The following performance indicators have been set:

- £19.2m long-term borrowing was undertaken in 2016/17 @ 2.21%. The target rate for the year is 25 year PWLB, the annual average for the year was 2.92%.
- Debt – Average rate movement year on year
- Pool rate in 2015/16: 4.81 %
- Pool rate in 2016/17: 4.81%
- Investments – Internal returns above the 7 day LIBID rate
- Average rate for the year 0.57% vs. annual average 7 day LIBID of 0.20%

Consultation and scrutiny input

27. The report does not require any internal consultation to be undertaken. The report has been discussed with the Council's external treasury management advisers.

Risk Assessment

28. The principal risks associated with treasury management are:

Risk	Mitigation
Loss of investments as a result of failure of counterparties	Limiting the types of investment instruments used, setting lending criteria for counterparties, and limiting the extent of exposure to individual counterparties
Increase in the net financing costs of the authority due to borrowing at high rates of interest / lending at low rates of interest	Planning and undertaking borrowing and lending in light of assessments of future interest rate movements, and by undertaking most long term borrowing at fixed rates of interest (to reduce the volatility of capital financing costs)

Public sector equality duties:

29. There are no proposals in this report, which require either a statement as to the relevance of public sector equality duties or an Equalities Impact Assessment.

Environmental checklist / eco impact assessment

30. There are no proposals in this report which have environmental impacts

Legal and Resource Implications

31. Legal- the Council is under a duty to manage its resources prudently and therefore due consideration must always be given to its borrowing and lending strategy. A wide range of local authority financial activities, including borrowing, lending, financial management, and the approval of types of investment vehicle are governed by legislation and various regulations. The Council is obliged to comply with these.

Advice provided by Shahzia Daya (Service Director: Legal and Democratic Services)

Financial

(a) Revenue

32. The financing costs arising from planned borrowing are provided for in the revenue budget and medium term financial plan.

Advice given by Jon Clayton (Principal Accountant)

(b) Capital

33. There is no direct capital investment implications contained within this report.

Land

34. There are no direct implications for this report.

Personnel

35. There are no direct implications for this report.

Appendices:

Appendix 1: Treasury Management Annual Report 2016/17

LOCAL GOVERNMENT (ACCESS TO INFORMATION) ACT 1985**Background Papers:**

36. Treasury Management Strategy 2016/17

https://democracy.bristol.gov.uk/Data/Full%20Council/201602161400/Agenda/0216_5.pdf

Appendix 1

Annual Report on the Treasury Management Service 2016/17 (Incorporating Outturn Prudential Indicators)

Introduction

1. This report summarises:

- The capital activity during the year
- What resources the Council applied to pay for this activity;
- The impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement);
- The reporting of the required prudential indicators;
- Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances;
- A summary of interest rate movements in the year;
- The detailed debt activity;
- The detailed investment activity;
- Local Issues

The Council's Capital Expenditure and Financing 2016/17

2. The Council undertakes capital expenditure to invest in the acquisition and enhancement of long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant 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.

3. The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

	2015/16 Actual £m	2016/17 Original Budget £m	2016/17 Final Budget £m	2016/17 Actual £m
Non-HRA capital expenditure	157	134	157	147
HRA capital expenditure	43	56	56	49
Total capital expenditure	200	190	213	196
Resourced by:				
Capital receipts	18	29	24	15
Capital grants	76	38	63	62
HRA Self Financing	37	32	32	34
Prudential borrowing	39	81	81	67
Revenue	30	10	13	18
Total Resources	200	190	213	196

The Council's Overall Borrowing Need

4. The Council's underlying need to borrow is called the Capital Financing Requirement (CFR). This figure is a gauge of the Council's debt position. It represents 2016/17 and prior years' net capital expenditure that has not yet been paid for by revenue or other resources.
5. Part of the Council's treasury activities is to address this borrowing need, either through borrowing from external bodies, or utilising temporary cash resources within the Council.
6. Reducing the CFR – Whilst under treasury management arrangements actual debt can be borrowed or repaid at any time within the confines of the annual treasury strategy, the Council is required to make an annual revenue charge to reduce the CFR – effectively a repayment of the Non-Housing Revenue Account (HRA) borrowing need. There is no statutory requirement to reduce the HRA CFR.
7. This statutory revenue charge is called the Minimum Revenue Provision - MRP. The total CFR can also be reduced by:
- the application of additional capital resources (such as unapplied capital receipts); or
 - charging more than the statutory revenue charge (MRP) each year through a Voluntary

Revenue Provision (VRP).

8. The Council's 2016/17 MRP Policy (as required by CLG Guidance) was originally approved on the 16th February 2016 and revised on the 13th December 2016 because the current MRP policy was created in 2007 and has been in place for 9 years.
9. A review of this policy was undertaken to ensure it remains prudent. This review resulted in a change to the MRP policy that will generate a medium-term revenue saving through the re-profiling of the provision. This saving has been made available to assist with mitigating the current revenue budgetary pressures along with providing a stable and deliverable financial position going forwards whilst ensuring the prudent management of the Council's finances generally.
10. The Council's CFR for the year is shown below, and represents a key prudential indicator. Accounting rule changes in previous years has meant that PFI schemes are now included on the balance sheet, which increases the Council's borrowing need, the CFR. No borrowing is actually required against these schemes as a borrowing facility is included in the contract.

CFR	General Fund 31 March 2016 Actual £m	General Fund 31 March 2017 Actual £m	HRA 31 March 2016 Actual £m	HRA 31 March 2017 Actual £m	Total CFR 31 March 2017 Actual £m
Opening balance	470	489	245	245	734
Add unfinanced capital expenditure (as above)	39	67	-	-	67
Less MRP/VRP	(11)	(8)	-	-	(8)
Less PFI & finance lease repayments	(9)	(5)	-	-	(6)
Closing balance	489	543	245	245	787

Treasury Position at 31 March 2017

11. Whilst the Council's gauge of its underlying need to borrow is the CFR, Finance can manage the Council's actual borrowing position by either:
 - Borrowing to the CFR; or
 - Choosing to utilise some temporary internal cash flow funds in lieu of borrowing or
 - Borrowing for future increases in the CFR (borrowing in advance of need).

12. The figures in this report are based on the principal amounts borrowed and invested and so may differ from those in the final accounts by items such as accrued interest.

	31 March 2016 Principal £m	31 March 2016 Average Rate %	31 March 2017 Principal £m	31 March 2017 Average Rate %
Fixed Interest Rate Debt	417	4.81%	433	4.81
Variable Interest Rate Debt	-	-	-	-
PFI / Service Contracts	152	-	146	-
Total Debt	569	4.81%	579	4.81
Debt administered of behalf of Unitary Authorities <small>(Ex Avon Debt)</small>	(48)	-	(46)	-
Revised Debt	521	4.81%	533	4.81
Capital Financing Requirement	734		787	
Over/(Under) borrowing	(213)		(254)	
Investment position				
Investments (Fixed & Call)	146	0.63%	70	0.57
Net borrowing position (excl leasing arrangements)	271	-	363	-

13. The fixed Interest rate debt is apportioned between the General Fund and HRA as set out in the table below.

Fixed Interest Rate Debt	31 March 2016		31 March 2017			
	£m	Principal £m	Average Rate%	£m	Principal £m	Average Rate%
General Fund	177	177	4.98	195	195	4.98
HRA	240	240	4.69	240	240	4.69
Total	417	417	4.81	433	433	4.81

14. The maturity structure of the debt portfolio (excluding accrued interest) was as follows:

	Approved Min Limit%	Approved Max Limit%	31 March 2016		31 March 2017	
			Actual £m	%	Actual £m	%
Under 12 Months	0	20	2	0.5	3	0.7
1 to 2 years	0	20	3	0.7	-	-
2 to 5 years	0	40	-	-	-	-
5 to 10 years	0	40	20	4.8	20	4.6
10 years and over	25	100	392	94.0	392	94.7
Total			417	100	433	100

15. The Council hold £100m of LOBOS with maturities averaging 50 years. Inherent within these

loan instruments are options (averaging an option every 4 years) that could give rise to the debt being repaid early. These loans are regularly reviewed with the current and expected structure of interest rates. The risk of the lenders exercising their options is currently low for the short to medium term. Therefore, the maturity of these loans in above table is based on their maturity date, 10 years and over.

16. The Council will continually review these loans in accordance with economic forecasts and will update the maturity structure of the debt portfolio accordingly and assess the future re-financing risks exposed to the authority and report any changes within future monitoring reports.
17. The authority's borrowing strategy is to delay borrowing and use its existing resources to support the Capital Programme to reduce its exposure to counterparty risk and the net interest cost of the authority. The authority, as planned, borrowed £19.2m from the PWLB on the 31st March 2017 at a preferential rate for the Bristol Temple Meads East Regeneration (Arena) scheme reducing the interest rate risk and liquidity risk exposed to the authority. No further borrowing was undertaken, as the authority maintained higher levels of investments than originally anticipated for a variety of reasons including the time taken to progress capital schemes where the source of financing was external borrowing.

Prudential Indicators and Compliance Issues

18. Some of the prudential indicators provide either an overview or specific limits on treasury activity. These are shown below:
19. **Net Borrowing and the CFR** - In order to ensure that borrowing levels are prudent over the medium term the Council's external borrowing, net of investments, must only be for a capital purpose. The table below highlights the Council's net borrowing position against the CFR. The Council has complied with this prudential indicator.

	31 March 2016 Actual £m	31 March 2017 Actual £m
Net borrowing position	271	363
CFR (excluding PFI)	582	641

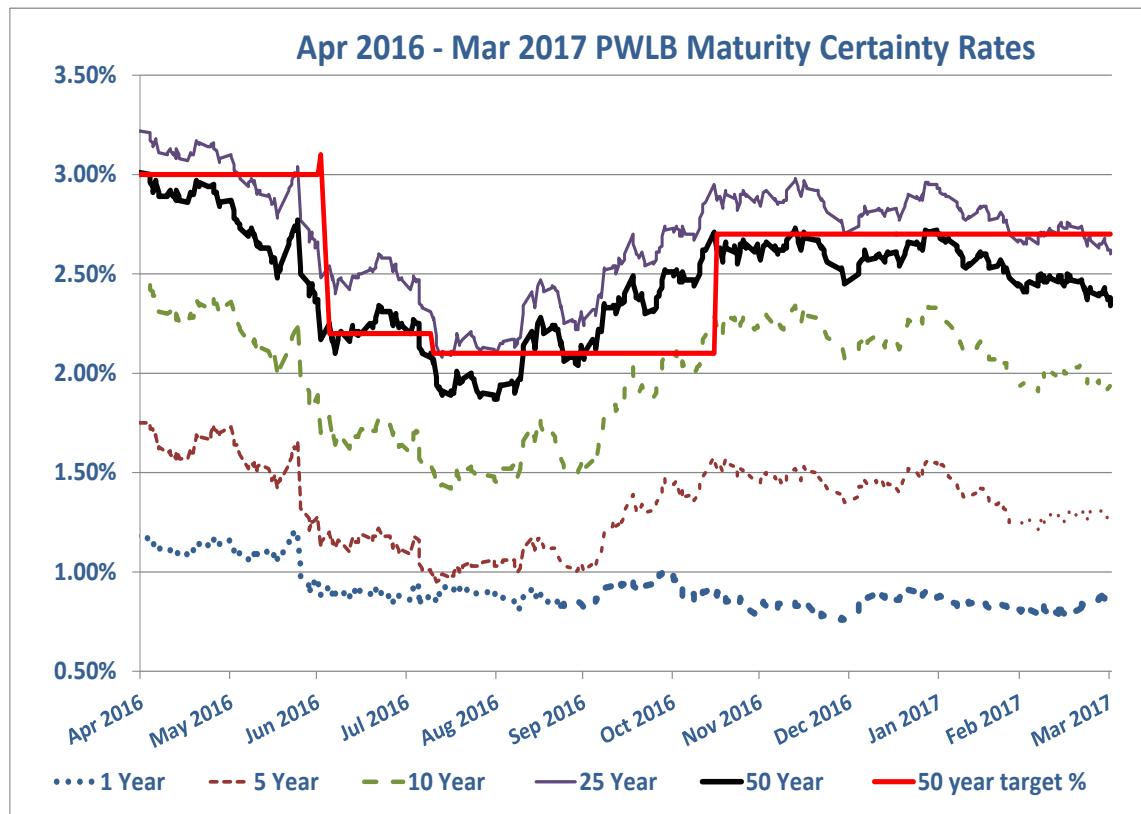
20. **The Authorised Limit** - The Authorised Limit is the "Affordable Borrowing Limit" required by Section 3 of the Local Government Act 2003. Once agreed the authorised limit cannot be breached. The Council does not have the power to borrow above this level. The table below demonstrates that during 2016/17 the Council has maintained gross borrowing within its Authorised Limit.
21. **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.
22. **Actual financing costs as a proportion of net revenue stream** - This indicator identifies the cost of capital (borrowing and other long term obligation costs net of investment income)

against the net revenue stream.

	2016/17 £m
Authorised Limit	799
Operational Boundary	589
Average gross borrowing position (including PFI)	579
Financing costs as a proportion of net revenue stream:	
General Fund	7.69%
HRA	8.66%

Borrowing Rates in 2016/17

23. PWLB borrowing rates - the graph below shows how PWLB certainty rates have fluctuated throughout the year. PWLB rates fell from April to June and then further following the referendum and Bank Rate cut, before staging a partial recovery through to December and then falling slightly through to the end of March.

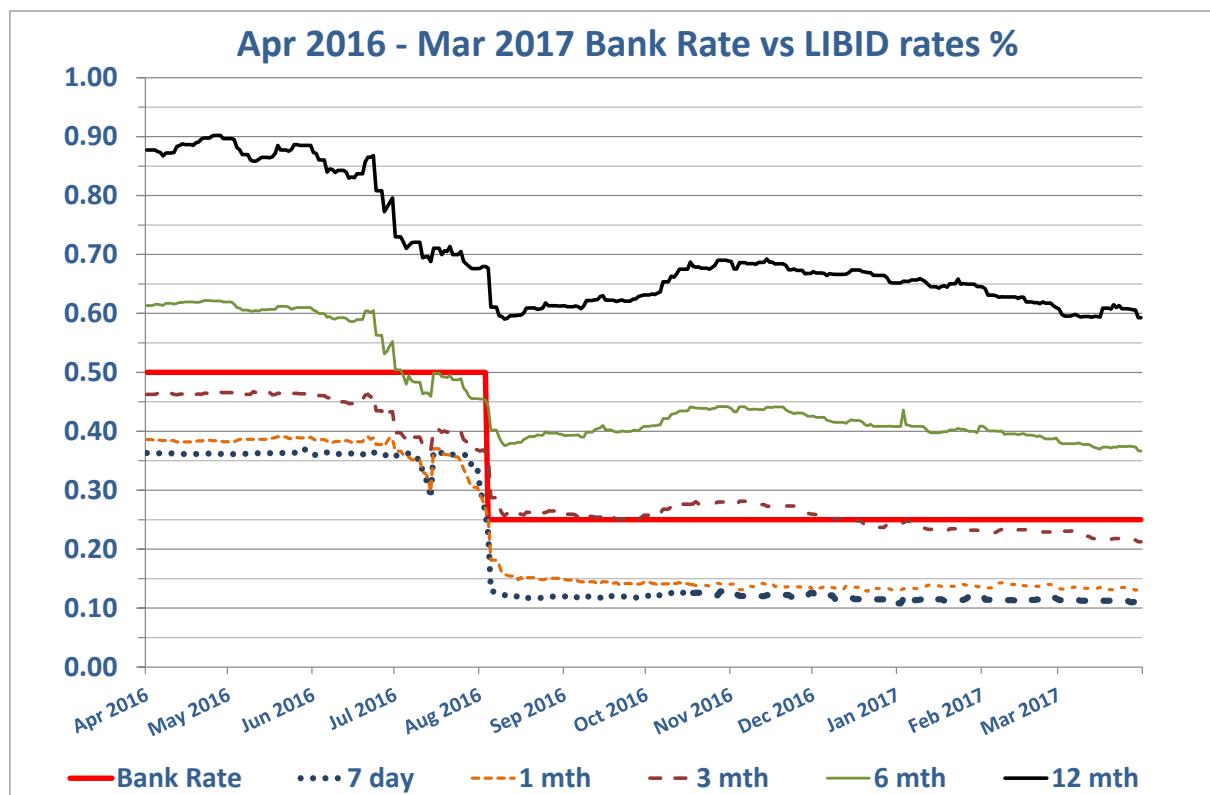


24. **Summary of Debt Transactions** – One new loan for £19.2 was drawn from the PWLB on the 31st March 2017 for a period of 46 years at a rate of 2.21% to fund capital expenditure for the Bristol Temple Meads East Regeneration (Arena) project.

25. The average rate of interest for long term borrowing for the year was 4.81%.

Investment Rates in 2016/17

26. 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 further lows in March 2017



27. The Council's investment policy is governed by CLG guidance, which has been implemented in the annual investment strategy approved by the Council on 16th February 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.

Local Issues

28. **Ethical Investment Policy-** The “Ethical Investment Policy” was approved by Cabinet on 15th December 2011 (updated February 2015). There are no breaches to report.

Regulatory Framework, Risk and Performance

29. The Council’s treasury management activities are regulated by a variety of professional codes and statutes and guidance:

- The Local Government Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;
- The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions have been made);
- Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act;
- The SI requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities;
- The SI also requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services;
- Under the Act the CLG has issued Investment Guidance to structure and regulate the Council’s investment activities.
- Under section 238(2) of the Local Government and Public Involvement in Health Act 2007 the Secretary of State has taken powers to issue guidance on accounting practices. Guidance on Minimum Revenue Provision was issued under this section on 8th November 2007.

30. The Council has complied with all of the above relevant statutory and regulatory requirements which require the Council to identify and, where possible, quantify the levels of risk associated with its treasury management activities. In particular its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach.

31. The Council has ensured that the principles of security, liquidity and yield have been adhered to within the treasury operation. This implies that the safeguarding of the principal investment with a suitable counterparty remains the Council’s highest priority followed by liquidity (i.e. ease of access to the principal amount deposited) and yield (i.e. return) on investment.