



ADUR & WORTHING
COUNCILS

Joint Governance Committee
Date: 26th September, 2017
Agenda Item 9
Joint Strategic Committee
Date: 10th October 2017
Agenda Item 7
Key Decision : No
Ward(s) Affected:

ANNUAL TREASURY MANAGEMENT REPORT 2016-17 ADUR DISTRICT COUNCIL AND WORTHING BOROUGH COUNCIL

REPORT BY THE DIRECTOR FOR DIGITAL AND RESOURCES

EXECUTIVE SUMMARY

1. PURPOSE

- 1.1 This report asks Members to note the Treasury Management performance for Adur and Worthing Councils for 2016/17 as required by regulations issued under the Local Government Act 2003.
- 1.2 This report asks Members to note that Worthing Borough Council was in breach of its counterparty limit with Lloyds Bank from 1st to 4th September 2017 (over a weekend). The Councils' Treasury Management Strategy Statement permits a maximum balance of £4m with Lloyds, but £5,807,500 was received after 3pm on 1st September in respect of the sale of the Aquarena site. £3m was transferred to another bank used for liquidity, but it was too late in the day to transfer the balance to the money market funds. There was no loss of Council funds due to the breach, but it is necessary to report the issue to Members.

2. RECOMMENDATIONS

2.1 Recommendation One

The Joint Governance Committee is recommended to note this report and refer any comments or suggestions to the next meeting of the Joint Strategic Committee on 10th October 2017.

2.2 Recommendation Two

The Joint Strategic Committee is recommended to note this report.

2.3 Recommendation Three

Both Joint Governance Committee and Joint Strategic Committee are asked to note the temporary breach of the Lloyds Bank counterparty limit.

3. CONTEXT

- 3.1 This report presents the treasury management activities and portfolio position for the 2016/17 financial year for both Adur District Council and Worthing Borough Council.
- 3.2 This is one of three treasury management reports that are required to be presented during the financial year (see Para. 4.1).
- 3.3 The presentation of the Annual Report is required through regulations issued under the Local Government Act 2003 to review the treasury management activities, the actual prudential indicators and the treasury related indicators for 2016/17. This report also meets the requirements of both the Treasury Management Code of Practice (The Code) and the Prudential Code for Capital Finance in Local Authorities (the Prudential Code), both of which are issued by The Chartered Institute of Public Finance and Accountancy (CIPFA).
- 3.4 To put the report in context, Treasury Management is defined by CIPFA 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”.
- 3.5 The Councils’ Treasury Management Strategy and Annual Investment Strategy place the security of investments as foremost in considering all treasury management dealing. By so doing it contributes towards the Council priorities set out in Platforms for our Places.

4. ISSUES FOR CONSIDERATION

- 4.1 For 2016/17 the minimum reporting requirements specified within the treasury management policy is that the Councils should receive the following:

The Annual Treasury Management Strategy (TMSS) in advance of the financial year – this was submitted to the meeting of the Joint Strategic Committee (JSC) on 2nd February 2016 and to the Joint Governance Committee (JGC) on 22nd March 2016.

A mid-year treasury update report – a joint in-house operations report for both Councils was submitted to the meeting of JSC on the 6th December 2016 and JGC on 22nd January 2017.

The Annual Report (this report) - to be submitted by 30th September after the year end, which compares the actual activity with the planned strategy.

- 4.2 The regulatory environment places a significant onus 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 management activities and highlights compliance with the Councils’ policies previously approved by members.

4. ISSUES FOR CONSIDERATION

4.3 The Annual Report also confirms that the Councils have complied with the requirement under the Code to give scrutiny to all of the above treasury management reports by the Joint Governance Committee.

4.4 This report summarises for both Councils the:

- Capital activity during the year (Appendices 2 and 3) and the impact on the Councils' underlying indebtedness (the Capital Financing Requirement) (Section 7)
- Overall treasury position (Section 6) identifying how the Councils have borrowed in relation to this indebtedness (Section 8), and the Councils' investment activity (Section 9 and Appendices 4 and 5)
- Reporting of the required prudential and treasury management indicators (Appendices 2 and 3)
- The treasury management strategy compared to the economic and interest rate environment (Section 5)

5. THE STRATEGY FOR 2016/2017

5.1 The expectation for interest rates within the Treasury Management Strategy for 2016/17 anticipated that Bank Rate would remain at 0.5%, before starting to rise from quarter 3 of 2016. Borrowing rates were expected to rise gradually for medium and longer term fixed rate borrowing. 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.

5.2 Against this background and the risks within the economic forecast, the strategy adopted by the Councils at JSC on 2 February 2016 was to be cautious with the 2016/17 treasury operations. The Chief Financial Officer would monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances. When borrowing, rates available from the PWLB would be reviewed, but advantage should be taken of very low short term borrowing rates in the market, to reduce the amount of interest payable.

5.3 This strategy was followed during the year and no amendments were required for either Adur District Council or Worthing Borough Council.

6. OVERALL TREASURY POSITION AS AT 31 MARCH 2017

6.1 Adur District Council's position at the beginning and end of year was as follows:-

	Principal at 31.03.16 £m	Average Rate of Return	Average Life in Years	Principal at 31.03.17 £m	Average Rate of Return	Average Life in Years
<u>Borrowing</u>						
PWLB	(56.315)	3.8%	28.1	(56.609)	3.7%	26.4
Other Borrowing	(17.953)	5.2%	50.0	(17.943)	5.2%	49.0
TOTAL BORROWING	(74.268)			(74.552)		
CFR	76.822			75.012		
(Over)/under borrowing	2.554			0.460		
<u>Investments:</u>						
Bonds	0.075	n/a	n/a	0.075	n/a	n/a
Long Term	2.000	1.90%	2.67	2.000	1.90%	1.67
Short Term	11.000	0.80%	< 1 year	13.350	0.59%	< 1 year
TOTAL INVESTMENTS	13.075			15.425		
NET INVESTMENTS	(61.193)			(59.127)		

6.2 Worthing Borough Council's position at the beginning and end of year was as follows:-

	Principal at 31.03.16 £m	Average Rate of Return	Average Life in Years	Principal at 31.03.17 £m	Average Rate of Return	Average Life in Years
<u>Borrowing</u>						
PWLB	(6.100)	2.09%	8.54	(9.300)	1.86%	9.47
Other Borrowing	(13.036)	0.79%	0.96	(13.009)	0.78%	0.63
TOTAL BORROWING	(19.136)			(22.309)		
CFR	23.361			22.384		
(Over)/under borrowing	4.225			0.075		
<u>Investments:</u>						
Bonds	0.075	n/a	n/a	0.075	n/a	n/a
Long Term	-	-	-	-	-	-
Short Term	8.050	0.72%	< 1 year	11.450	0.54%	< 1 year
TOTAL INVESTMENTS	8.125			11.525		
NET INVESTMENTS	(11.011)			(10.784)		

7. THE BORROWING REQUIREMENT and DEBT

7.1 The Councils undertake capital expenditure on long-term assets. These activities may be financed in one of two ways:

- financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Councils' 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.

7.2 The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement. The tables below compare the Gross Debt against the underlying need to borrow (the Capital Financing Requirement, CFR) thereby highlighting any over or under borrowing. This comparison is one of the Prudential Indicators of affordability under the Prudential Code to show that borrowing levels are prudent over the medium term, and sustained for capital investment purposes – i.e that the Council is not borrowing to support revenue expenditure.

7.3 Accordingly, the amount of gross debt should not exceed the CFR for 2016/17 (plus any expected changes to the CFR over 2017/18 and 2018/19) except in the short term.

Adur District Council

7.4 The introduction of HRA self-financing resulted in a revision to the CIPFA Code of Practice, recommending the inclusion of a separate HRA Treasury Management Strategy for the HRA. This recommendation was adopted and reported as part of the overall Treasury Management Strategy to the JSC in 2011, and is updated each year as part of the HRA Budget Report.

7.5 The formulation of a separate Treasury Management Strategy is important because The Code requires transparency to be given to the relative positions of the General Fund and HRA so that decisions may be considered separately for treasury management purposes. Thus, the relative borrowing and CFR position at the end of the year is analysed between General Fund and HRA as follows:

CFR v Long Term Debt Position at 31 March 2017	ADUR DISTRICT COUNCIL		
	General Fund £000s	HRA £000s	Total £000s
Actual Long term Debt 01/04/16	12,978	61,290	74,268
New Long term Debt Raised in year	2,000	-	2,000
Long Term Debt Repaid in Year	(7)	(1,709)	(1,716)

7. THE BORROWING REQUIREMENT and DEBT

Adur District Council

CFR v Long Term Debt Position at 31 March 2017	ADUR DISTRICT COUNCIL		
	General Fund £000s	HRA £000s	Total £000s
Capital Financing Requirement	14,909	60,103	75,012
(Over)/Under Borrowing	(62)	522	460
HRA Debt Limit	N/A	68,912	68,912
HRA Borrowing Headroom (Debt Limit – Actual Debt)	N/A	9,331	N/A

7.6 For Adur District Council, the HRA is under borrowed by £522k. The General Fund is over borrowed by £62k because a £2m loan from the PWLB was taken when the rates dropped in March, in order to fund planned capital expenditure in early 2017/18.

Adur District Council	31 March 2016 Actual	31 March 2017 Original Estimate	31 March 2017 Actual
CFR (£m)	76.822	79.384	75.012
External Debt	(74.268)	(72.549)	(74.552)
(Over)/under borrowing	2.554	6.835	0.460

Worthing Borough Council

7.7 Worthing Borough Council was under-borrowed by £75k at 31 March 2017.

Worthing Borough Council	31 March 2016 Actual	31 March 2017 Original Estimate	31 March 2017 Actual
CFR (£m)	23.361	42.944	22.384
External Debt	(19.136)	(28.350)	(22.309)
(Over)/under borrowing	4.225	14.594	0.075

8. BORROWING OUTTURN for 2016/17

The following loans were taken during the year:

8.1 Adur General Fund (no borrowing was undertaken for the HRA)

This loan was taken early to fund expenditure in 2017/18 due to the low rates available in March 2017.

Lender	Principal	Type	Interest Rate	Maturity
PWLB	£2m	Fixed interest rate	0.96%	20/03/2022

Adur also held precepts of up to £282k on behalf of Lancing Parish Council for most of the year as temporary borrowing.

8.2 Worthing Borough Council

Short term borrowing was used due to the low interest rates available in the market and the anticipated capital receipt from the sale of the Aquarena site. Some long term PWLB borrowing was taken to offset potential interest rate rises in the next few years.

Lender	Principal	Type	Interest Rate	Maturity
PWLB	£2m	Fixed interest rate	2.16%	13/06/2036
PWLB	£2m	Fixed interest rate	0.96%	20/03/2022
Barnsley Doncaster Council	£2m	Fixed interest rate	0.60%	03/04/2017
London Borough of Ealing	£2m	Fixed interest rate	0.62%	05/06/2017
Hertfordshire CC	£5m	Fixed interest rate	0.55%	10/07/2017
Mid Sussex DC	£2m	Fixed interest rate	0.60%	02/05/2017

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

8. BORROWING OUTTURN for 2016/17

8.4 Adur District Council's debt repayments were as follows:-

Lender	Principal £000s	Type	Interest Rate %	Period Lent	Duration
Lancing PC	282	Variable	LA 7 day notice	Apr 2016 - Mar 2017	Variable
PWLB - HRA	1,706	Fixed Principal and Interest	3.03%	March '12 – March'42	30 Years
Salix Finance	10	Variable Profile	0%	Various	4 Years

8.5 Worthing Borough Council's debt repayments were as follows:-

Lender	Principal £000	Type	Interest Rate	Period Lent	Duration
Islington Finance	5,000	Fixed Principal & Interest	0.75%	May 2015 - Nov 2016	18 months
London Borough of Ealing	2,000	Fixed Principal & Interest	0.58%	May 2015 - May 2016	< 1 year
Hyndburn Council	2,000	Fixed Principal & Interest	0.48%	July 2015 - July 2016	< 1 year
West Yorkshire P & CC	2,000	Fixed Principal & Interest	0.50%	June 2015 - June 2016	< 1 year
PWLB	200	Fixed Principal & Interest	2.32%	Oct 2014 – Oct 2024	10 years
PWLB	200	Fixed Principal & Interest	1.62%	Dec 2014 – Dec 2019	5 years
PWLB	350	Fixed Principal & Interest	2.07%	Dec 2015 – Dec 2015	10 years
Salix Finance	26	Fixed Principal	0%	Feb 2013 – Sept 2017	4 years

9. INVESTMENT OUTTURN FOR 2016/17

9.1 **Investment Policy** – the Councils' investment policy is governed by CLG guidance, which has been implemented in the Annual Investment Strategy approved by the Council on 2 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 Councils had no liquidity difficulties.

9.2 **Investments held by Adur District Council:**

Adur District Council maintained an average balance of £19.125m of internally managed funds, which earned an average rate of return of 0.83%. The comparable performance indicator is the average 3 month LIBID rate, which was 0.315%. This compares with a budget assumption of £23.981m investment balances earning an average rate of 1.25%. The Treasury investment returns included in the reported income of the Council for 2016/17 amount to £160,144. The Weighted Average Rate of Return of the Council's investments at 31 March 2017, as benchmarked by the Shared Service advisors (Capita) was 0.76%, which compares favourably to the benchmark group of 87 Non-Metropolitan Districts which had a Weighted Average Rate of Return of 0.57%.

9.3 **Investments held by Worthing Borough Council:**

Worthing Borough Council maintained an average balance of £15.456m of internally managed funds, which earned an average rate of return of 0.56%. The comparable performance indicator is the average 3 month LIBID rate, which was 0.315%. This compares with a budget assumption of £12.391m investment balances earning an average rate of 1.0%. The Treasury investment returns included in the reported income of the Council for 2016/17 amount to £88,484. The Weighted Average Rate of Return of the Council's investments at 31 March 2017, as benchmarked by the Shared Service advisors (Capita) was 0.54%. This is slightly lower than the benchmark group of 87 Non-Metropolitan Districts which had a Weighted Average Rate of Return of 0.57%. However Worthing's relatively low investment balance means that a higher proportion of the funds needs to be kept liquid to cover operating expenditure.

Authority	Average Investments During 2016/17	Interest Returned on all Investments	Interest Rate Achieved %
Adur	£19.1m	£160k	0.83%
Worthing	£15.5m	£88k	0.54%

10. MINIMUM REVENUE PROVISIONS (MRP) FOR REPAYMENT OF DEBT

10.1 The Councils, in accordance with legislation, make a provision from revenue to enable the repayment of borrowing that has been undertaken to fund the capital programme. This provision is known as the Minimum Revenue Provision (MRP) and is charged to the General Fund Revenue Account each year.

10. MINIMUM REVENUE PROVISIONS (MRP) FOR REPAYMENT OF DEBT

10.2 For 2016/17 an amount of £889k has been provided in the Adur District Council General Fund and a voluntary amount of £1.717m has been set aside for the HRA.

10.3 For 2016/17 an amount of £977k has been provided in the Worthing Borough Council revenue accounts.

11. CURRENT PERIOD TREASURY MATTERS – Worthing Borough Council

11.1 The sale of the Aquarena site was due to complete on 31 August 2017. However there was a delay in finalising the conditions and the purchase proceeds were not transferred to the Council until after 3pm on the afternoon of Friday 1st September. Given the uncertainty around the completion of the sale, the decision was made not to place the funds until the Council had confirmed receipt of the sum, thereby avoiding the risk of a considerable unauthorised overdraft.

11.2 There is an early cut off time for placing funds in money markets so it was not possible to invest the full amount of nearly £6m before close of business. Consequently Worthing Borough Council was in breach of its counterparty limit of £4m with Lloyds Bank from 1st to 4th September, because it held £5.5m in Lloyds accounts. The purpose of the policy is to limit the Council's exposure in the event of the failure of a counterparty. In this instance there was no loss of funds, but it is a requirement of the Treasury Management Strategy that Members must be notified of any breach.

12. ENGAGEMENT AND COMMUNICATION

12.1 The Adur and Worthing Councils' treasury management team provides treasury services to Mid Sussex District Council through a shared services arrangement (SSA). The SSA is provided under a Service Level Agreement that was renewed from 18th October 2016, and which defines the respective roles of the client and provider authorities for a period of three years.

12.2 Information and advice is supplied throughout the year by Capita Asset Services Ltd, the professional consultants for the Councils' shared treasury management service.

13. FINANCIAL IMPLICATIONS

- 13.1 This report has no quantifiable additional financial implications to those outlined above. Interest payable and interest receivable arising from treasury management operations, and annual revenue provisions for repayment of debt, form part of the revenue budget.

Finance Officer: Sarah Gobey

Date: 8th September 2017

14. LEGAL IMPLICATIONS

- 14.1 The presentation of the Annual Report is required by regulations issued under the Local Government Act 2003 to review the treasury management activities, the actual prudential indicators and the treasury related indicators for 2016/17.

Legal Officer: Susan Sale

Date: 12th September 2017

Background Papers

Joint Treasury Management Strategy Statement and Annual Investment Strategy Report 2016/17 to 2018/19 – Joint Strategic Committee 2 February 2016, and Joint Governance Committee, 22 March 2016

Joint Half-Year In-House Treasury Management Operations Report 1 April – 30 September 2016 for Adur District Council and Worthing Borough Council – Joint Strategic Committee, 6 December 2016 and Joint Governance Committee, 22 January 2017

Capita Asset Services Ltd Annual Report Template 2016/17

Capita Benchmarking Club Reports

Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes (CIPFA, November 2011)

The Prudential Code for Capital Finance in Local Authorities (CIPFA, May 2013)

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SUSTAINABILITY & RISK ASSESSMENT

1. ECONOMIC

The treasury management function ensures that the Councils have sufficient liquidity to finance their day to day operations. Borrowing is arranged as required to fund the capital programmes. Available funds are invested according to the specified criteria to ensure security of the funds, liquidity and, after these considerations, to maximise the rate of return.

2. SOCIAL

2.1 Social Value

Matter considered and no issues identified.

2.2 Equality Issues

Matter considered and no issues identified.

2.3 Community Safety Issues (Section 17)

Matter considered and no issues identified.

2.4 Human Rights Issues

Matter considered and no issues identified.

3. ENVIRONMENTAL

Matter considered and no issues identified.

4. GOVERNANCE

4.1 The Councils' Treasury Management Strategy and Annual Investment Strategy place the security of investments as foremost in considering all treasury management dealing. By so doing it contributes towards the Council priorities contained in Platforms for our Places.

4.2 The operation of the treasury management function is as approved by the Councils' Treasury Management Strategy and Annual Investment Strategy 2016/17 - 2018/19, submitted and approved before the commencement of the 2016/17 financial year.

4.3 In the current economic climate the security of investments is paramount, the management of which includes regular monitoring of the credit ratings and other incidental information relating to credit worthiness of the Councils' investment counterparties.

THE ECONOMY AND INTEREST RATES

The following commentary has been supplied by Capita Asset Services Ltd, the professional consultants for the Council's shared treasury management services provider. The context is significant as it describes the backdrop against which treasury management activity has been undertaken during the year.

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.

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

INVESTMENT RATES IN 2016/17

