APPENDIX 1

Cherwell District Council

Treasury Management and Prudential Indicators Report 2016/17

Part A **Treasury Management Outturn and Indicators**

Part B **Prudential Indicators**

Part A Treasury Management Outturn and Indicators

1.Introduction

In 2012 the Council adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2011 Edition (the CIPFA Code) which requires the Council to approve a treasury management annual report after the end of each financial year.

This report fulfils the Council's legal obligation to have regard to the CIPFA Code.

The Council's treasury management strategy for 2016/17 was approved at a meeting of the Council on 16/2/2016. The Council has invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Council's treasury management strategy.

2. External Context 2016/17 - provided by Arlingclose

Economic background: Politically, 2016/17 was an extraordinary twelve month period which defied expectations when the UK voted to leave the European Union and Donald Trump was elected the 45th President of the USA. Uncertainty over the outcome of the US presidential election, the UK's future relationship with the EU and the slowdown witnessed in the Chinese economy in early 2016 all resulted in significant market volatility during the year. Article 50 of the Lisbon Treaty, which sets in motion the 2-year exit period from the EU, was triggered on 29th March 2017.

UK inflation had been subdued in the first half of 2016 as a consequence of weak global price pressures, past movements in sterling and restrained domestic price growth. However 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% year/year in April 2016 to 2.3% year/year in March 2017.
In addition to the political fallout, the referendum's outcome also prompted a decline in household, business and investor sentiment. The repercussions on economic growth were judged by the Bank of England to be sufficiently severe to prompt its Monetary Policy Committee (MPC) to cut the Bank Rate to 0.25% in August and embark on further gilt and corporate bond purchases as well as provide cheap funding for banks via the Term Funding Scheme to maintain the supply of credit to the economy.

Despite growth forecasts being downgraded, economic activity was fairly buoyant and GDP grew 0.6%, 0.5% and 0.7% in the second, third and fourth calendar quarters of

2016. The labour market also proved resilient, with the ILO unemployment rate dropping to 4.7% in February, its lowest level in 11 years.

Following a strengthening labour market, in moves that were largely anticipated, the US Federal Reserve increased rates at its meetings in December 2016 and March 2017, taking the target range for official interest rates to between 0.75% and 1.00%.

Financial markets: Following the referendum result, gilt yields fell sharply across the maturity spectrum on the view that Bank Rate would remain extremely low for the foreseeable future. After September there was a reversal in longer-dated gilt yields which moved higher, largely due to the MPC revising its earlier forecast that Bank Rate would be dropping to near 0% by the end of 2016. The yield on the 10-year gilt rose from 0.75% at the end of September to 1.24% at the end of December, almost back at pre-referendum levels of 1.37% on 23rd June. 20- and 50-year gilt yields also rose in Q3 2017 to 1.76% and 1.70% respectively, however in Q4 yields remained flat at around 1.62% and 1.58% respectively.

After recovering from an initial sharp drop in Q2, equity markets rallied, although displaying some volatility at the beginning of November following the US presidential election result. The FTSE-100 and FTSE All Share indices closed at 7342 and 3996 respectively on 31st March, both up 18% over the year. Commercial property values fell around 5% after the referendum, but had mostly recovered by the end of March.

Money market rates for overnight and one week periods remained low since Bank Rate was cut in August. 1- and 3-month LIBID rates averaged 0.36% and 0.47% respectively during 2016-17. Rates for 6- and 12-months increased between August and November, only to gradually fall back to August levels in March, they averaged 0.6% and 0.79% respectively during 2016-17.

Credit background: Various indicators of credit risk reacted negatively to the result of the referendum on the UK's membership of the European Union. UK bank credit default swaps saw a modest rise but bank share prices fell sharply, on average by 20%, with UK-focused banks experiencing the largest falls. Non-UK bank share prices were not immune, although the fall in their share prices was less pronounced.

Fitch and Standard & Poor's downgraded the UK's sovereign rating to AA. Fitch, S&P and Moody's have a negative outlook on the UK. Moody's has a negative outlook on those banks and building societies that it perceives to be exposed to a more challenging operating environment arising from the 'leave' outcome.

None of the banks on the Council's lending list failed the stress tests conducted by the European Banking Authority in July and by the Bank of England in November, the latter being designed with more challenging stress scenarios, although Royal Bank of Scotland was one of the weaker banks in both tests. The tests were based on banks' financials as at 31st December 2015, 11 months out of date for most. As part of its creditworthiness research and advice, the Council's treasury advisor Arlingclose regularly undertakes analysis of relevant ratios - "total loss absorbing capacity" (TLAC) or "minimum requirement for eligible liabilities" (MREL) - to determine whether there would be a bail-in of senior investors, such as local authority unsecured investments, in a stressed scenario.

3. Local context

On 31 March 2017 the Council had investments of £30.6m, which included £12.9m shares in Graven Hill. This is an overall decrease of £13.4 from the 2016 total of £44.0m which included £5.9m shares in Graven Hill. Treasury investments therefore decreased by £20.4 from £38.1m in 2016 to £17.7m in 2017.
The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors and the year-on-year change are summarised in table 1 below.

Table 1: Balance Sheet Summary

	31.3.16 Actual £m	**2016/17 Movement £m**	**31.3.17 Actual £m**
General Fund CFR	-5.880	8.274	2.394
Less: Usable reserves	-24.852	3.313	-21.539
Less: Working capital	-13.220	1.786	-11.434
Net investments	**-43.952**	**13.373**	**-30.579**

The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low. The treasury management position as at 31st March 2017 and the year-on-year change in show in table 2 below.

Table 2: Treasury Management Summary

	31.3.16 Balance £m	**2016/17 Movement £m**	**31.3.17 Balance £m**	**31.3.17 Rate %**
Long-term borrowing	0	0	0	-
Short-term borrowing	0	0	0	-
Total borrowing	**0**	**0**	**0**	**-**
Long-term investments	1.8	-1.8	0	-
Short-term investments	24.0	12.5	11.5	0.60
Cash and cash equivalents	11.8	-5.3	6.5	0.22
Total investments	**37.6**	**-19.6**	**18.0**	**0.41**
Net investments	**37.6**	**-19.6**	**18.0**	**0.41**

Note: the figures in the table are from the balance sheet in the Council's statement of accounts, but adjusted to exclude operational cash, accrued interest and other accounting adjustments

4. Borrowing Activity

At 31 March 2017 the Council was debt free. However, the Council's spending commitments such as Graven Hill, Build! and other Capital Programmes over the next few years may exhaust current reserves and require the Council to borrow in 2017/18.

We are therefore taking advice from our Treasury advisers, tracking PWLB lending rates and monitoring the general economic outlook, so that we are well prepared. Depending on economic conditions and timing, it may be advantageous to borrow earlier than required in order secure the best available rates.

5. Investment Activity

The Council holds sizeable invested funds, representing income received in advance of expenditure plus balances and reserves held. During 2016/17, the Council's treasury investment balances ranged between £13.0m and £56.7m due to timing differences between income and expenditure. The year-end investment position and the year-on-year change is shown in table 3 below.

Table 3: Investment Position

	31.3.16 Balance £m	2016/17 Movement £m	31.3.17 Balance £m	31.3.17 Rate %
Banks & building societies (unsecured)	24.6	-10.8	13.8	0.51
Government (incl. local authorities)	1.8	-1.8	0	-
Money Market Funds	11.2	-7.0	4.2	0.21
Total investments	37.6	-19.6	18.0	0.41

Both the CIPFA Code and government guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

6. Performance Report

The Council measures the financial performance of its treasury management activities both in terms of its impact on the revenue budget and its relationship to benchmark interest rates, as shown in table 4 below.

Table 4: Performance

	Actual £k	Budget £k	Over/ -Under	Actual %	Benchmark %	Over/ -Under %
Total investments income	230	175	55	0.52	0.60	-0.08

7. Compliance Report

The Chief Finance Officer is pleased to report that all treasury management activities undertaken during 2016/17 complied fully with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy

8. Treasury Management Indicators

The Council measures and manages its exposures to treasury management risks using the following indicators:

Interest Rate Exposures: This indicator is set to control the Council's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of net principal borrowed was:

	31.3.17 Actual	2016/17 Limit	Complied
Upper limit on fixed interest rate exposure	0	0	✓
Upper limit on variable interest rate exposure	0	0	✓

Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or the transaction date if later. All other instruments are classed as variable rate.

Maturity Structure of Borrowing: This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing were:

	31.3.17 Actual %	Upper Limit %	Lower Limit %	Complied
Under 12 months	0	100	0	✓
12 months and within 24 months	0	100	0	✓
24 months and within 5 years	0	100	0	✓
5 years and within 10 years	0	100	0	✓
10 years and above	0	100	0	✓

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

Principal Sums Invested for Periods Longer than 364 days: The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:

	2016/17 £m	2017/18 £m	2018/19 £m
Actual principal invested beyond year end	0	0	0
Limit on principal invested beyond year end	15	15	15
Complied	✓	✓	✓

Part B Prudential Indicators

Introduction: The Local Government Act 2003 requires the Council to have regard to the Chartered Institute of Public Finance and Accountancy's *Prudential Code for Capital Finance in Local Authorities* (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Council has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

This report compares the approved indicators with the outturn position for 2016/17. Actual figures have been taken from or prepared on a basis consistent with, the Council's statement of accounts.

Capital Expenditure: The Council's capital expenditure and financing may be summarised as follows.

Capital Expenditure and Financing	2016/17 Estimate £m	2016/17 Actual £m	Difference £m
Total Expenditure	**29.504**	**23.361**	**-6.143**
Capital Receipts	0.580	12.698	12.118
Government Grants	0.375	1.825	1.450
Reserves	28.549	8.274	-20.275
Revenue	0	0.564	0.564
Total Financing	**29.504**	**23.361**	**-6.143**

Capital Financing Requirement: The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose.

Capital Financing Requirement	31.03.17 Estimate £m	31.03.17 Actual £m	Difference £m
Total CFR	**28.549**	**8.274**	**-20.275**

The CFR fell as capital expenditure financed by debt was outweighed by resources put aside for debt repayment.

Actual Debt: The Council's actual debt at 31st March 2017 was as follows:

Debt	31.03.17 Estimate £m	31.03.17 Actual £m	Difference £m
Total Debt	**0**	**0**	**0**

Gross Debt and the Capital Financing Requirement: In order to ensure that over the medium term debt will only be for a capital purpose, the Council should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence.

Debt and CFR	31.03.17 Estimate £m	31.03.17 Actual £m	Difference £m
Total debt	0	**0**	0
Capital financing requirement	28,549	**8.274**	-20.275
Headroom	**28,549**	**8.274**	**-20.275**

Total debt remained below the CFR during the forecast period.

Operational Boundary for External Debt: The operational boundary is based on the Council's estimate of most likely (i.e. prudent but not worst case) scenario for external debt. It links directly to the Council's estimates of capital expenditure, the capital financing requirement and cash flow requirements, and is a key management tool for in-year monitoring. Other long-term liabilities comprise finance lease, Private Finance Initiative and other liabilities that are not borrowing but form part of the Council's debt.

Operational Boundary and Total Debt	**31.03.17 Boundary £m**	**31.03.17 Actual Debt £m**	**Complied**
Borrowing	50	**0**	✓
Other long-term liabilities	0	**0**	✓
Total Debt	**50**	**0**	✓

Authorised Limit for External Debt: The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Council can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

Authorised Limit and Total Debt	**31.03.17 Boundary £m**	**31.03.17 Actual Debt £m**	**Complied**
Borrowing	55	**0**	✓
Other long-term liabilities	0	**0**	✓
Total Debt	**55**	**0**	✓

Ratio of Financing Costs to Net Revenue Stream: This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

Ratio of Financing Costs to Net Revenue Stream	**31.03.17 Estimate %**	**31.03.17 Actual %**	**Difference %**
General Fund	3.24	**-0.61**	-3.85

This ratio is negative as the Council is in a net investment position and therefore interest foregone to finance capital expenditure was less than investment income.

Adoption of the CIPFA Treasury Management Code: The Council adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition* in February 2012