Subject:	**TREASURY MANAGEMENT YEAR-END REPORT**
Meeting and Date:	**Governance – 29 June 2017** **Cabinet – 3 July 2017** **Council – 19 July 2017**
Report of:	**Mike Davis, Director of Finance, Housing and Community**
Portfolio Holder:	**Councillor Mike Connolly, Portfolio Holder for Corporate Resources and Performance**
Decision Type:	**Non-Key Decision**
Classification:	**Unrestricted**
Purpose of the report:	To provide details of the Council's treasury management for the financial year ended 31 March 2017 (Q4) and an update of activity to date.
Recommendation:	That the report is received

1. **Summary**

This report covers the outturn for the year ending March 2017, and will also be included in the Cabinet agenda. The main points to note are that, while we are outperforming the benchmark, interest rates are down, we are working to get the best returns we can, but nonetheless, we are likely to see falling income from interest in the future that will be an additional budget pressure. To mitigate this, we have appointed new treasury advisers, Arlingclose Ltd, from 1st April 2017, to explore alternative treasury management options.

As at 31st March 2017, the Council's in-house investment portfolio totalled £55.7m (see Appendix 2). The revised Treasury Management Strategy Statement (TMSS) for 2016/17 was updated and approved at the end of November 2016, with the view to increasing borrowing limits only (see section 5 below).

Additionally, cashflow funds were higher than anticipated (£10.7m at 31st March 2017) due to a capital receipt of £7.6m on 29th March 2017 relating to sale of land at Aylesham, which was temporarily placed in the Standard Life Money Market Fund. Cashflow funds have since reduced (to £6.3m at 31st May 2017), partly as a result of re-investing the capital receipt.

The Council has remained within its Treasury Management guidelines, except for briefly exceeding the counter party limit of £8m with Standard Life Money Market Fund, which stood at £9.5m for two days only, due to the Aylesham capital receipt. The Council has remained within the Prudential Code guidelines during the period.

The Council's investment return for the year was 0.50%, which outperformed the benchmark[1] by 0.18%. The Council's budgeted investment return for 2016/17 was £329k, and performance for the year was £342k, which is a favourable variance of

[1] The "benchmark" is the interest rate against which performance is assessed. DDC use the London Inter-Bank Bid Rate or LIBID, as its benchmark.

£13k. This is partly due to the use of notice accounts and the higher level of balances available for deposit generally, which has enabled us to maintain projected investment income against a background of decreasing interest rate returns.

2. Introduction and Background

CIPFA (the Chartered Institute of Public Finance and Accountancy) issued the revised Code of Practice for Treasury Management in November 2011: it recommends that members should be updated on treasury management activities at least twice a year, but preferably quarterly. This report therefore ensures this council is implementing best practice in accordance with the Code.

In order to comply with the CIPFA code referred to above, a brief summary is provided below and Appendix 1 contains a full report from the Council's treasury management advisers, Arlingclose Ltd. Please note that our previous treasury advisors, Capita Asset Management, ceased to provide the advisory function as at 31st March 2017 and the details at Appendix 1 have therefore been provided by their successors, Arlingclose.

Members are asked to note that in order to minimise the resource requirements in producing this report, Arlingclose's report has been taken verbatim with regards to their explanation of the economic background. Generally, treasury advisers use a more journalistic style than is used by our officers, but in order to avoid changing the meaning or sense of Arlingclose's work, this has not been edited out.

Council adopted the 2016/17 Treasury Management Strategy Statement (TMSS) on 4 March 2016 as part of the 2016/17 Budget and Medium Term Financial Plan. This has been updated twice during the year, for borrowing limits (see section 5 below, "New Borrowing").

With the appointment of new treasury advisers, we expect to revise the TMSS for 2017/18 to potentially use additional investment instruments and consider other approaches to the Council's investment strategy. Approval will be sought for the revised TMSS through the normal committee reporting processes prior to taking any action recommended by the new treasury advisers that is currently outside the TMSS for 2017/18 approved at Council on 1st March 2017.

3. Annual Investment Strategy

The Gilt holding of £1.9 million remains with King and Shaxson and will be held until its maturity date of July 2018.

The investment portfolio as at the end of March is attached at Appendix 2. Since the end of the quarter, three deposits have matured. The £8m Barclays' deposit that matured on 5th April 2017 has been invested with two Local Authorities for a period of three months from 10th April at a rate of 0.30% (£5m with Suffolk County Council and £3m with Blackpool Borough Council). The Leeds Building Society investment of £5m that matured on 6th April 2017 was returned to cashflow funds and used to repay a £4m temporary loan from South Holland District Council. Separately, £7.5m of the capital receipt received from the sale of land at Aylesham has been invested with Birmingham City Council for 12 months at a rate of 0.70%. The Lloyds investment of £1m that matured on 11th May 2017 has not yet been reinvested and is currently part of the Bank of Scotland 'call account' balance.

Cash flow funds decreased from £14.2m at 31st December 2016 to £10.7m at 31st March 2017 (see Appendix 2). This is normal and expected, as there are reduced council tax receipts in February and March (generally paid over 10 months from April to January), while preceptors on the Collection Fund are paid their shares of Council Tax income evenly over the year. There was also a further six-monthly PWLB loan instalment of £2.35m paid for the 2016/17 year at the end of March. Cashflow funds have decreased from £10.7m at the end of March 2017 to £6.3m at the end of May 2017 (see Appendix 4), which partly arises from the decision to invest the Aylesham land sale money in a fixed term deposit with another local authority.

Please note that, following the Brexit vote and the reduction in bank base rate, interest rates dropped with all institutions. There is some expectation of a further base rate cut and some institutions may price this in, leading to further reductions in rates offered and pressure on investment income for 2017/18. However, the Arlingclose central case is for bank rate to remain at 0.25%, but there is a low possibility of a drop to close to zero.

4. Economic Background

The report attached (Appendix 1) contains information up to the end of March 2017; since then we have received the following update from Arlingclose. Please note that any of their references to quarters are based on *calendar* years:

Introduction

Commodity prices slid back in April with oil falling below $50 a barrel – a 5 month low – as did industrial metal prices (iron ore, copper, zinc). The primary factor in the oil price fall was oversupply and a lack of belief in OPEC's (Organisation of Petroleum Exporting Countries) ability to deliver on agreed production caps of members.

UK Data

UK Consumer Price Index (CPI) rose over the quarter and the data print for May showed CPI at 2.9%, its highest since June 2013. The effect of the fall in fuel prices was offset by rises in a number of other categories in the CPI 'basket' as the fall in the value of sterling following June 2016's referendum result continued to feed through into higher import prices. The most recent labour market data for April 2017 showed that the unemployment rate at 4.6% remained at its lowest since July 1975 but that the squeeze on real wages (i.e. after inflation) is intensifying and resulting in negative real wage growth. Q1 GDP data released in April and revised in May showed economic activity growing at a much slower pace of 0.2%. However recent surveys indicate that the slowdown in the first quarter is being viewed as an anomaly and that Q2 GDP could rebound. Understandably, the Bank of England made no change to monetary policy and none is expected at its meeting on 15th June.

US Data

Having raised rates in March, the US Federal Reserve made no change to monetary policy at the conclusion of its meeting in May. The recent weakness witnessed in the first print of Q1 US GDP was noted in the accompanying statement but the Fed viewed this as a transitory issue and was of the view that the GDP path and household spending would recover during 2017. The Fed's outlook supports two further rate hikes during 2017 with the first likely in June when a 0.25% increase would take US official interest rates into the 1.00%-1.25% range. (please note that the outcome of the Federal Reserve meeting will be known around 1900 hours on Wed 14th June).

Impact of General Election

The non-economic event which has and will continue to have a significant impact in the medium term is June's General Election which was called by Prime Minister Theresa May to resolve uncertainty and in the hope of providing her an enhanced mandate to enter the forthcoming Brexit negotiations. The shock result was of no winner in overall political party terms, and the ultimate outcome of this election now hinges on the ability of the Conservatives to reach an agreement with the Democratic Unionist Party (DUP) in Northern Ireland and its 10 sitting MPs to form a coalition government that can work cohesively over a challenging two year period ahead. On a more immediate note there is real pressure to demonstrate that a Queen's Speech can be passed in the new Parliament with Brexit negotiations due to commence on 19th June so as to remain within the 2 year timeframe triggered by Article 50. This political impasse clearly results in an enhanced level of political uncertainty, however the potential for a so-called hard Brexit are now much diminished, reducing the associated economic headwinds for the UK economy from a 'no deal' or hard Brexit.

Up to now the reaction from the markets on the election's outcome has been fairly muted, business confidence now hinges a lot on the progress or not on Brexit negotiations, the success of concluding new trade treaties and whether or not the UK continues to remain part of the EU customs union post the country's exit from the EU (the pre-election objective of the government was for the UK to be outside the EU Common External Tariff).

Bank Base Rate

Arlingclose expects the Bank of England will look through periods of high inflation, and maintain its low-for-longer stance on policy rates for an extended period.

BANK RATE	
Q2 2017	0.25%
Q3 2017	0.25%
Q4 2017	0.25%
Q1 2018	0.25%

5. New Borrowing

The Council's borrowing portfolio is attached at Appendix 3. The only new borrowing undertaken during the quarter was a short-term loan of £4m. This was taken out on 22nd March 2017 to cover an expected shortfall in cash flow money over the year-end, but this shortfall did not materialise due to the capital receipt from the sale of land at Aylesham. The loan was repaid on 21st April 2017. The interest paid was minimal and is offset within the final investment income figure of £342k, which exceeded budget by £13k.

Council approved a revised TMS on 28th September 2016 to increase *borrowing limits* to enable the borrowing to support the Dover Leisure Centre project to be undertaken, and a further update on 30th November 2016 to approve a further increase in *borrowing limits* to fund the separate Property Investment Strategy, which itself was approved at the 30th November meeting. Details of any specific borrowing will be advised to Members as part of the quarterly update reports when it is undertaken. None was undertaken in the quarter to March 2017. However, it is likely that borrowing *will* be undertaken in 2017/18, dependent on timing of projects and progress under the property investment strategy.

6. **Debt Rescheduling**

At this time it is not of benefit to the Council to consider rescheduling of its long-term debt.

7. **Compliance with Treasury and Prudential Limits**

The Council has operated within the Prudential Indicators in compliance with the Council's Treasury Management Practices, but has briefly exceeded the level of permissible deposit with Standard Life Money Market Fund as mentioned above (for two days only). Otherwise the Council has remained within its Treasury Management guidelines.

8. **Corporate Implications**

Comment from the Section 151 Officer: Finance have no further comments to make. (SG)

Comment from the Solicitor to the Council: The Solicitor to the Council has been consulted in the preparation of this report and has no further comments to make.

Comment from the Equalities Officer: This report does not specifically highlight any equalities implications however, in discharging their responsibilities members are required to comply with the public sector equality duty as set out in section 149 of the Equality Act 2010 http://www.legislation.gov.uk/ukpga/2010/15

Appendices

Appendix 1 – Arlingclose treasury management outturn report for 2016/17

Appendix 2 – Investment portfolio as at 31 March 2017

Appendix 3 – Borrowing portfolio as at 31 March 2017

Appendix 4 – Investment portfolio as at 31 March 2017

Background Papers

Medium Term Financial Plan 2016/17 – 2018/19

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