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Cyngor Bwrdeistref Sirol
MERTHYR TUDFUL
MERTHYR TYDFIL
County Borough Council

FULL COUNCIL REPORT

Date Written	5th December 2018
Report Author	Adele Lewis
Service Area	Accountancy
Exempt/Non Exempt	Non Exempt
Committee Date	19th December 2018

To: Mayor, Ladies and Gentlemen

Treasury Management Outturn Report 2017/18

1.0 SUMMARY OF THE REPORT

1.1 The Treasury Management Outturn Report outlines the Council's performance in respect of:

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

2.0 RECOMMENDATIONS that

2.1 The Treasury Management Outturn Report for 2017/18 be received.

2.2 The actual 2017/18 Treasury Indicators be received.

3.0 INTRODUCTION AND BACKGROUND

3.1 The Treasury Management Outturn Report for 2017/18 is attached at Appendix A, for Members' attention. This report is a requirement of the Chartered Institute for Public Finance and Accountancy's Code of Practice on Treasury Management.

3.2 The Council employs Arlingclose as its Treasury Management consultant to give specialist advice on all Treasury Management matters including borrowing and investment requirements. This advice has been followed in producing the Treasury Management Outturn Report.

4.0 FINANCIAL IMPLICATIONS

4.1 Financial and performance information is included within the body of the report.

5.0 INTEGRATED IMPACT ASSESSMENT

5.1

	Positive Impacts	Negative Impacts	Not Applicable
1. Merthyr Tydfil Well-being Objectives	4 of 4	0 of 4	0 of 4
2. Sustainable Development Principles - How have you considered the five ways of working: • Long term • Prevention • Integration • Collaboration • Involvement	5 of 5	0 of 5	0 of 5
3. Protected Characteristics *(including Welsh Language)*	0 of 10	0 of 10	10 of 10
4. Biodiversity	0 of 1	0 of 1	1 of 1

Summary:

The main positive impacts are that the Treasury Management Policy and Annual Investment strategy supports the Council to achieve its Well-being Objectives through its Treasury Management Activities.

GARETH CHAPMAN
CHIEF EXECUTIVE

COUNCILLOR ANDREW BARRY
CABINET MEMBER FOR GOVERNANCE AND CORPORATE SERVICES

BACKGROUND PAPERS		
Title of Document(s)	**Document(s) Date**	**Document Location**
Prudential Indicators 2017/18	Council 22nd March 2017	Accountancy/Intranet Committee Agendas and Minutes
Treasury Management Policy and Annual Investment Strategy 2017/18	Council 22nd March 2017	Accountancy/Intranet Committee Agendas and Minutes

Audited Statement of Accounts for Year Ended 31st March 2018	26th September 2018	Accountancy/Intranet Committee Agendas and Minutes
Final Accounts Working Papers 2017/18	April 2018 to September 2018	Accountancy
Does the report contain any issue that may impact the Council's Constitution?		**No**

Consultation has been undertaken with the Corporate Management Team in respect of each proposal(s) and recommendation(s) set out in this report.

Appendix A

MERTHYR TYDFIL COUNTY BOROUGH COUNCIL ANNUAL TREASURY REPORT 2017/18

1.0 Introduction and Background

1.1 In March 2010 the Authority adopted he Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code) which requires the Authority to approve a treasury management annual report after the end of each financial year. This report fulfils the Authority's legal obligation to have regard to the CIPFA Code.

1.2 The Authority's treasury management strategy for 2017/18 was approved at full Council on 22nd March 2017.

The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested sums and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Authority's treasury management strategy.

2.0 External Context

2.1 Appendix 1 outlines an Economic Commentary and Local Authority Regulatory Changes for the 2017/18 financial year.

3.0 Treasury Management Summary

3.1 On 31st March 2018, the Authority had net borrowing of £83m arising from its revenue and capital income and expenditure. The Authority's strategy was 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 2018 and the year on year change is shown in table 1 below

Table1 Treasury Management Summary

Description	31st March 2017 £'000	2017/18 Movement £'000	31st March 2018 £'000	Rate/ Return %
Long term borrowing	64,134	(3,186)	60,948	6.68
Short term borrowing	20,550	14,637	35,187	1.39
Total Borrowing	**84,684**	**11,451**	**96,135**	**4.74**
Long term investments	0	0	0	0.00
Short term investments	0	13,500	13,500	0.65
Total Investments	**0**	**13,500**	**13,500**	**0.65**
Net Borrowing	**84,684**	**(2,049)**	**82,635**	**5.41**

4.0 Borrowing activity

4.1 At 31st March 2018, the Authority held £96m loans, an increase of £11m to the previous year. The year-end borrowing position and the year on year change is shown in table 2 below:

Table 2 Borrowing Position

Description	31st March 2017 £'000	2017/18 Movement £'000	31st March 2018 £'000	Rate/ Return %
Public Works Loan Board	54,684	(2,549)	52,135	7.35
Banks (Lender's Option Borrower's Option Loans)	12,000	0	12,000	4.50
Banks (fixed-term)	0	0	0	0.00
Local authorities (short-term)	18,000	14,000	32,000	0.61
Total Borrowing	**84,684**	**11,451**	**96,135**	**4.73**

4.2 The Authority's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Authority's long-term plans change being a secondary objective.

4.3 This strategy allowed the Authority to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

4.4 For the majority of the year the "cost of carry" analysis performed by the Authority's treasury management advisor Arlingclose did not indicate value in borrowing in advance for future years' planned expenditure and therefore none was taken. The Authority continues to hold £12m of LOBO (Lender's Options Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. No banks exercised their option during 2017/18.

5.0 Investment activity

5.1 The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. The year end investment position and the year on year change is shown in table3 below

Table 3 Investment Position

Description	31st March 2017 £'000	2017/18 Movement £'000	31st March 2018 £'000	Rate/ Return %
Banks	0	0	0	0
Building Societies	0	10,000	10,000	0.61
Government (inc local authorities)	0	3,500	3,500	0.75
Total investments	**0**	**13,500**	**13,500**	**0.65**

5.2 Both the CIPFA Code and government guidance require the Authority 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 Authority'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.

6.0 Performance and Financial Implications

6.1 The Authority measures the financial performance of its treasury management activities in terms of its impact on the revenue budget as shown in table 4 below.

Table 4 Performance

Description	Estimate £'000	Outturn £'000
Public Works Loan Board Loans	4,046	4,041
Lender's Option Borrower's Option Loans	539	540
Short Term Borrowing	44	66
Short Term Investments	(9)	(31)
Total Borrowing	**4,620**	**4,616**

6.2 The outturn for debt interest paid in 2017/18 was £4.647m against a budgeted interest of £4.629m.

6.3 The outturn for investment income received in 2017/18 was £31,000 against a budgeted interest of £9,000.

7.0 Compliance Report

7.1 The Chief Finance Officer is pleased to report that all treasury management activities undertaken during 2017/18 complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy. Compliance with specific Debt and investment limits are demonstrated in tables 5 and 6 below.

Table 5 Debt limits

Description	2017/18 Maximum £'000	31.3.18 Actual £'000	2017/18 Operational Boundary £'000	2017/18 Authorised Limit £'000	Complied
Borrowing	97,957	97,957	107,240	117,914	✓

7.2 Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cashflow, and this is not counted as a compliance failure.

Table 6 Investment Limits

Description	2017/18 Maximum £'000	31.3.18 Actual £'000	2017/18 Limit £'000	Complied
Banks and Building Societies	5,000	4,000	5,000	✓
UK Local Authorities	3,500	3,500	5,000	✓

8.0 Treasury Management Indicators

8.1 The Authority measures and manages its exposures to treasury management risks using the following indicators.

8.1.1 Interest Rate Exposures:

This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on fixed and variable interest rate exposures, expressed as the amount of net interest payable was:

Description	31.3.18 Actual £'000	2017/18 Limit £'000	Complied
Upper limit on fixed interest rate exposure	4,570	4,833	✓
Upper limit on variable interest rate exposure	554	586	✓

8.1.2 Maturity structure of Borrowing:

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

Description	31.3.18 Actual	Upper Limit	Lower Limit	Complied
Under 12 months	6%	5%	0%	☒
12 months and within 24 months	6%	6%	0%	✓
24 months and within 5 years	20%	17%	0%	☒
5 years and within 10 years	18%	23%	0%	✓
10 years and above	50%	49%	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.

This indicator is showing as non-compliant for three areas, the indicator was set using the 31st March 2017 year end position as an estimate and should have been forecast to the 31st March 2018 position. The result is that several loans have been repaid within 2017/18 and have moved into a lower bracket of one year less.

8.1.3 Principal Sums invested for Periods longer than 364 days:

The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. Long-term principal sum invested to final maturities beyond the period end were:

Description	2017/18	2018/19	2019/20
Principal Sums Invested for Periods Longer than 364 days	0	0	0
Complied	✓	✓	✓

Appendix 1

External Context *(Data as at 09/4/18)*

Economic commentary

2017-18 was characterised by the push-pull from expectations of tapering of Quantitative Easing (QE) and the potential for increased policy rates in the US and Europe and from geopolitical tensions, which also had an impact.

The UK economy showed signs of slowing with latest estimates showing GDP, helped by an improving global economy, grew by 1.8% in calendar 2017, the same level as in 2016. This was a far better outcome than the majority of forecasts following the EU Referendum in June 2016, but it also reflected the international growth momentum generated by the increasingly buoyant US economy and the re-emergence of the Eurozone economies.

The inflationary impact of rising import prices, a consequence of the fall in sterling associated with the EU referendum result, resulted in year-on-year CPI rising to 3.1% in November before falling back to 2.7% in February 2018. Consumers felt the squeeze as real average earnings growth, i.e. after inflation, turned negative before slowly recovering. The labour market showed resilience as the unemployment rate fell back to 4.3% in January 2018. The inherent weakness in UK business investment was not helped by political uncertainty following the surprise General Election in June and by the lack of clarity on Brexit, the UK and the EU only reaching an agreement in March 2018 on a transition which will now be span Q2 2019 to Q4 2020. The Withdrawal Treaty is yet to be ratified by the UK parliament and those of the other 27 EU member states and new international trading arrangements are yet to be negotiated and agreed.

The Bank of England's Monetary Policy Committee (MPC) increased Bank Rate by 0.25% in November 2017. It was significant in that it was the first rate hike in ten years, although in essence the MPC reversed its August 2016 cut following the referendum result. The February *Inflation Report* indicated the MPC was keen to return inflation to the 2% target over a more conventional (18-24 month) horizon with 'gradual' and 'limited' policy tightening. Although in March two MPC members voted to increase policy rates immediately and the MPC itself stopped short of committing itself to the timing of the next increase in rates, the minutes of the meeting suggested that an increase in May 2018 was highly likely.

In contrast, economic activity in the Eurozone gained momentum and although the European Central Bank removed reference to an 'easing bias' in its market communications and had yet to confirm its QE intention when asset purchases end in September 2018, the central bank appeared some way off normalising interest rates. The US economy grew steadily and, with its policy objectives of price stability and maximising employment remaining on track, the Federal Reserve Open Market Committee (FOMC) increased interest rates in December 2017 by 0.25% and again in March, raising the policy rate target range to 1.50% - 1.75%. The Fed is expected to deliver two more increases in 2018 and a further two in 2019. However, the imposition of tariffs on a broadening range of goods initiated by the US, which has led to retaliation by China, could escalate into a deep-rooted trade war having broader economic consequences including inflation rising rapidly, warranting more interest rate hikes.

Financial markets

The increase in Bank Rate resulted in higher money markets rates: 1-month, 3-month and 12-month LIBID rates averaged 0.32%, 0.39% and 0.69% and at 31st March 2018 were 0.43%, 0.72% and 1.12% respectively.
Gilt yields displayed significant volatility over the twelve-month period with the change in sentiment in the Bank of England's outlook for interest rates. The yield on the 5-year gilts which had fallen to 0.35% in mid-June rose to 1.65% by the end of March. 10-year gilt yields also rose from their lows of 0.93% in June to 1.65% by mid-February before falling back to 1.35% at year-end. 20-year gilt yields followed an even more erratic path with lows of 1.62% in June, and highs of 2.03% in February, only to plummet back down to 1.70% by the end of the financial year.

The FTSE 100 had a strong finish to calendar 2017, reaching yet another record high of 7688, before plummeting below 7000 at the beginning of 2018 in the global equity correction and sell-off.

Local Authority Regulatory Changes

Revised CIPFA Codes

CIPFA published revised editions of the Treasury Management and Prudential Codes in December 2017. The required changes from the 2011 Code are being incorporated into Treasury Management Strategies and monitoring reports.

The 2017 Prudential Code introduces the requirement for a Capital Strategy which provides a high-level overview of the long-term context of capital expenditure and investment decisions and their associated risks and rewards along with an overview of how risk is managed for future financial sustainability. Where this strategy is produced and approved by full Council, the determination of the Treasury Management Strategy can be delegated to a committee. The Code also expands on the process and governance issues of capital expenditure and investment decisions. The Authority will prepare a Capital Strategy for the 2019/20 financial year.

In the 2017 Treasury Management Code the definition of 'investments' has been widened to include financial assets as well as non-financial assets held primarily for financial returns such as investment property. These, along with other investments made for non-treasury management purposes such as loans supporting service outcomes and investments in subsidiaries, must be discussed in the Capital Strategy or Investment Strategy. Additional risks of such investments are to be set out clearly and the impact on financial sustainability is be identified and reported.

Amendments to Capital Finance Legislation

The Welsh Government published the Local Authorities (Capital Finance and Accounting) (Wales) (Amendment) Regulations 2018 in March 2018. It amends and clarifies erstwhile regulations so that investments in corporate bonds and shares in FCA (Financial Conduct Authority) approved UCITS (Undertakings for the Collective Investment of Transferable Securities) funds, Real Estate Investment Trusts (REITs) and investment schemes approved by HM Treasury are no longer treated as capital expenditure. This legislation came into effect in the 2017/18 financial year. It enables the Authority to invest in these instruments, if appropriate for the Authority's circumstance and objectives, without the potential revenue cost of MRP (Minimum Revenue Provision) and without the proceeds from sale being considered a capital receipt.

MiFID II

As a result of the second Markets in Financial Instruments Directive (MiFID II), from 3rd January 2018 local authorities were automatically treated as retail clients but could "opt up" to professional client status, providing certain criteria was met which includes having an investment balance of at least £10 million and the person(s) authorised to make investment decisions on behalf of the authority have at least a year's relevant professional experience. In addition, the regulated financial services firms to whom this directive applies have had to assess that that person(s) have the expertise, experience and knowledge to make investment decisions and understand the risks involved.

The Authority has met the conditions to opt up to professional status and has done so in order to maintain its erstwhile MiFID II status prior to January 2018. The Authority will continue to have access to products including money market funds, pooled funds, treasury bills, bonds, shares and to financial advice.