TREASURY MANAGEMENT ANNUAL REPORT

1. Outline

This report reviews the results of the full financial year as well as providing quarter 4 monitoring information in line with normal quarterly management reporting. The most significant elements of treasury management activity during 2016/17 were:

- At 31st March 2017, the Council's total loan debt net of treasury investments stood at £3,064.8m, compared to the net loan debt of £2,986.8m as at 31st March 2016.

- The increase in loan debt is largely due to cash outflows from the capital receipts and other reserves which had been accumulated in previous years (including capital receipts from the sale of the NEC and Grand Central in 2015/16).

- City Council treasury investments held at 31st March 2017 were £29.3m. The Council also held investments of £36.3m as accountable body.

- The City Council did not breach any of its prudential limits set under the Local Government Act 2003 and the CIPFA Prudential Code for Capital Finance.

- Loan interest, repayment charges and associated costs totalled £257.0m gross, and £20.1m to corporate budgets after recharges to other services. This was £16.9m below the revised budget of £37.0m.

2. Background

2.1 The City Council, like all local authorities, is permitted by government to finance capital investment and day to day cash flows from borrowing, in accordance with the prudential borrowing system. The Council's net loan debt at 31st March 2017 stood at £3,064.8m (excluding accountable body investments). This report reviews how the debt and associated investments were managed during the financial year 2016/17.

2.2 The City Council has adopted CIPFA's Code of Practice for Treasury Management in the Public Services which includes the requirement to present a treasury management Annual Report.

2.3 Loans and investments are shown at nominal value unless otherwise indicated, consistent with budget and monitoring reports and the Prudential Indicators. The basis of accounting in the Financial Accounts is different in some cases where required by proper accounting practices.

3. The objective of treasury management

3.1 CIPFA defines the objective of Treasury Management as "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; and the pursuit of optimum performance consistent with those risks". In balancing risk against return, Local Authorities should be more concerned to avoid risks than to maximise return. In particular, this requires a balance to be struck when borrowing between:

a) The security offered by long term fixed rate funding;

b) The expected cost of short term and variable rate funding, compared with long term funding

Similarly, when investing surplus funds the emphasis should be on the security of capital invested rather than maximising the rate of return.

4. Financial markets during 2016/17

4.1 A significant event that had an influence on financial markets in the 2016-17 financial year was the UK EU referendum on 23 June. The result 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. The impact of the referendum vote and the subsequent market reaction can be seen in the PWLB borrowing rates available to local authorities (see chart at Annex 1).

Actual performance was significantly better than the Bank's pessimistic forecasts of August. After a disappointing quarter 1, the three subsequent quarters produced an annual growth for 2016 overall, compared to 2015, of 1.8%, which was the second fastest rate of growth of any of the G7 countries. This meant that the MPC did not cut Bank Rate again after August, however inflation has risen rapidly 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 not raise Bank Rate, 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 by the end of March 2017, in response to increasing concerns around inflation.

Market developments elsewhere also impacted the UK economy

- quarterly growth in the USA was very volatile but there was a strong performance since mid-2016, and strongly rising inflation, prompted the Fed into raising rates in December 2016 and March 2017. The US is the first major western country to start on a progressive upswing in rates. Overall growth in 2016 was 1.6%.
- The EU is furthest away from an upswing in rates; the European Central Bank (ECB) has cut rates into negative territory, provided huge tranches of cheap financing and been doing major quantitative easing purchases of debt during 2016-17 in order to boost growth from consistently weak levels, and to get inflation up from near zero towards its target of 2%. The action taken by the ECB has resulted in economic growth improving significantly 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.

4.2 Credit risks for the Council's investments remained relatively stable during the year, reflecting continued recovery from the worst of the credit crunch.

5. Treasury strategy and activities during the year

5.1 The City Council's actual net loan debt at 31st March 2017 was £3,064.8m compared to the expected net loan debt at the time of the Original Budget in March 2016 of £3,450.5m. This is due to a combination of a difference in the opening budget on 1st

April 2016 compared to that forecast when the 2016/17 budget was set, and slippage in the capital expenditure and other cashflow movements across the Council. New long term loans taken amounted to £40.0m compared to the original assumption of £150.0m new long term borrowing. The lower than planned level of long term borrowing is due to the lower overall borrowing requirement.

5.2 The treasury strategy for the year:

- Maintained a balanced strategy which enabled the Council to benefit from current low short term interest rates, maintaining a significant short term and variable rate loan portfolio
- Acknowledged the risk that maintaining a significant short term and variable rate loan debt may result in increasing borrowing costs in the longer term, but balanced this against the savings arising from cheaper variable rates in the short term
- Reviewed treasury management activity in the context of the Council's current financial position together with the outlook for interest rates
- Continuously reviewed the advantages and disadvantages of different sources of borrowing.

5.3 Opportunities to improve risk management or make savings by prematurely repaying loans are kept under review. No loans were prematurely repaid during 2016/17.

5.4 The City Council's Treasury Strategy in recent years has sought to maintain a significant exposure to short-term and variable-rate borrowing in order to take advantage of cheaper short-term rates at around bank base rate. The variable and short term borrowing of £358.7m at 31st March 2017 (see Table 7.1) was borrowed at an average rate of 0.40% versus the new long-term loan taken out during the year at 2.56% (see Annex 2) which generated a saving of £7.75m per annum.

5.5 The majority of the Council's borrowing needs during the year were met from short term borrowing, minimising interest costs. £40.0m of long term fixed rate borrowing was taken during the year, all from the PWLB (details are provided at Annex 2).

5.6 HRA loan debt is accounted for separately in accordance with the two pool debt system, which the City Council introduced following the reform of Housing Subsidy. The level of HRA loan debt has increased from £1,094.7m to £1,122.3m, taking account new capital investment and HRA debt repayment provision (or MRP) in the year. No long term loans were taken for the HRA during the year, in order to maximise the HRA's exposure to cheaper short term interest rates.

6. <u>Investment management</u>

6.1 Under the current treasury strategy, a working balance of around £40m short term investments is targeted in order to provide liquidity to meet cash flow fluctuations.

6.2 Treasury Investments are made in accordance with the creditworthiness criteria in the Treasury Management Policy and are also reported to Cabinet as part of the quarterly capital monitoring reports. Lending has continued to be limited to very short periods (of no longer than three months) to the institutions within the Treasury Management Policy's criteria. A range of information has been used to assess investment risk, in addition to credit ratings. Regular meetings are held to review outstanding investments and criteria for new investments in the light of developments in market conditions. None of the City Council's treasury investments has been impaired or suffered default.

6.3 Actual investments are reported quarterly to Cabinet as part of accountability for decisions made under treasury management delegations. Annex 3.1 lists all investments made during Quarter 4 of 2016/17 for the City Council.

6.4 Investments outstanding at 31st March 2017 are summarised as follows.

Period Outstanding	Value Invested £m	Interest Rate %
Instant Access	29.28	0.22%
Fixed Overnight	0.00	-
Up to 3 months	0.00	-
3 to 6 months	0.00	-
Total	29.28	-

6.5 The Council also continues to manage substantial funds as Accountable Body for an increasing number of Government programmes, the Growing Places Fund, the Regional Growth Fund and the Advanced Manufacturing Supply Chain Initiative (AMSCI). These funds are managed by the City Council but are not the Council's own money. The unspent balance of the funds at 31st March 2017 was £36.3m as set out in Annex 3.2. These funds are being invested in accordance with the Accountable Body agreements in very low-risk deposits with the UK Government (predominantly in the DMADF).

7. Debt profile

7.1 Long term borrowing is taken at a range of maturities to ensure that debt maturing in any year does not generally exceed 10% of total external debt, and that short-term/variable rate debt does not exceed the limit of 30% set in the City Council's prudential indicators (full maturity profile at Annex 4). This ensures that the Council is not overly exposed to the risk of high refinancing costs in any year. The following table summarises how the maturity profile of the Council's debt changed within the year.

Debt Profile (General Fund and HRA combined)	**31.03.16**	**31.03.17**	**Average Interest Payable at 31.03.17 %**
	£m	**£m**	
Fixed rate over 40 years	444.0	430.0	4.1
Fixed rate 20 to 40 years	1,155.7	1,189.7	4.6
Fixed rate 10 to 20 years	700.9	654.4	6.4
Fixed rate 5 to 10 years	229.0	270.3	5.7
Fixed rate 1 to 5 years	165.9	146.0	5.5
Fixed < 1 year (note 1)	82.7	45.0	9.3
Variable and short term	267.3	358.7	0.4
Gross Debt	3,045.5	3,094.1	
Investments < 1 year	(58.7)	(29.3)	0.2
Net Debt	2,986.8	3,064.8	

Nominal value of debt and excluding accruals; LOBO loans at final maturity

The average interest rate paid on all the City Council's debt in 2016/17 was 4.76%. This includes the cost of historic debt taken when fixed interest rates were higher.

The average maturity profile of 22.3 years assumes that Lender's Option Borrower's Option loans with options are repaid at their final maturity date. A full maturity profile at 31st March 2017 compared to 31st March 2016 is given in Annex 4.

7.2 At 31st March 2017, the gross loan debt of the HRA and General Fund pools is summarised by maturity as follows:

Debt Profile	**31.03.17 HRA £m**	**31.03.17 GF £m**	**31.03.17 TOTAL £m**
Fixed rate over 40 years	248.7	181.3	430.0
Fixed rate 20 to 40 years	510.0	679.7	1,189.7
Fixed rate 10 to 20 years	131.2	523.2	654.4
Fixed rate 5 to 10 years	60.8	209.5	270.3
Fixed rate 1 to 5 years	50.7	95.3	146.0
Fixed < 1 year	17.5	27.5	45.0
Variable and short term	103.3	255.4	358.7
Total Debt	1,122.3	1,971.8	3,094.1

Note: LOBOS shown at FINAL Maturity Date

The Council's short term loan debt at 31 March is more balanced between the General Fund and the HRA than in previous years. The loans attributed to the HRA at the Reform in April 2012 were all long term loans, but no additional long term borrowing has been taken for the HRA during the year, in order to maximise the HRA’s exposure to cheaper short term interest rates.

8. Revenue cost of borrowing

8.1 The actual net cost of borrowing to corporate treasury budgets was £20.1m. This is £16.9m below the budget, due largely to interest savings arising from lower than budgeted interest rates, and recovery of additional prudential borrowing costs from services. The Treasury Management outturn is summarised in the table below:

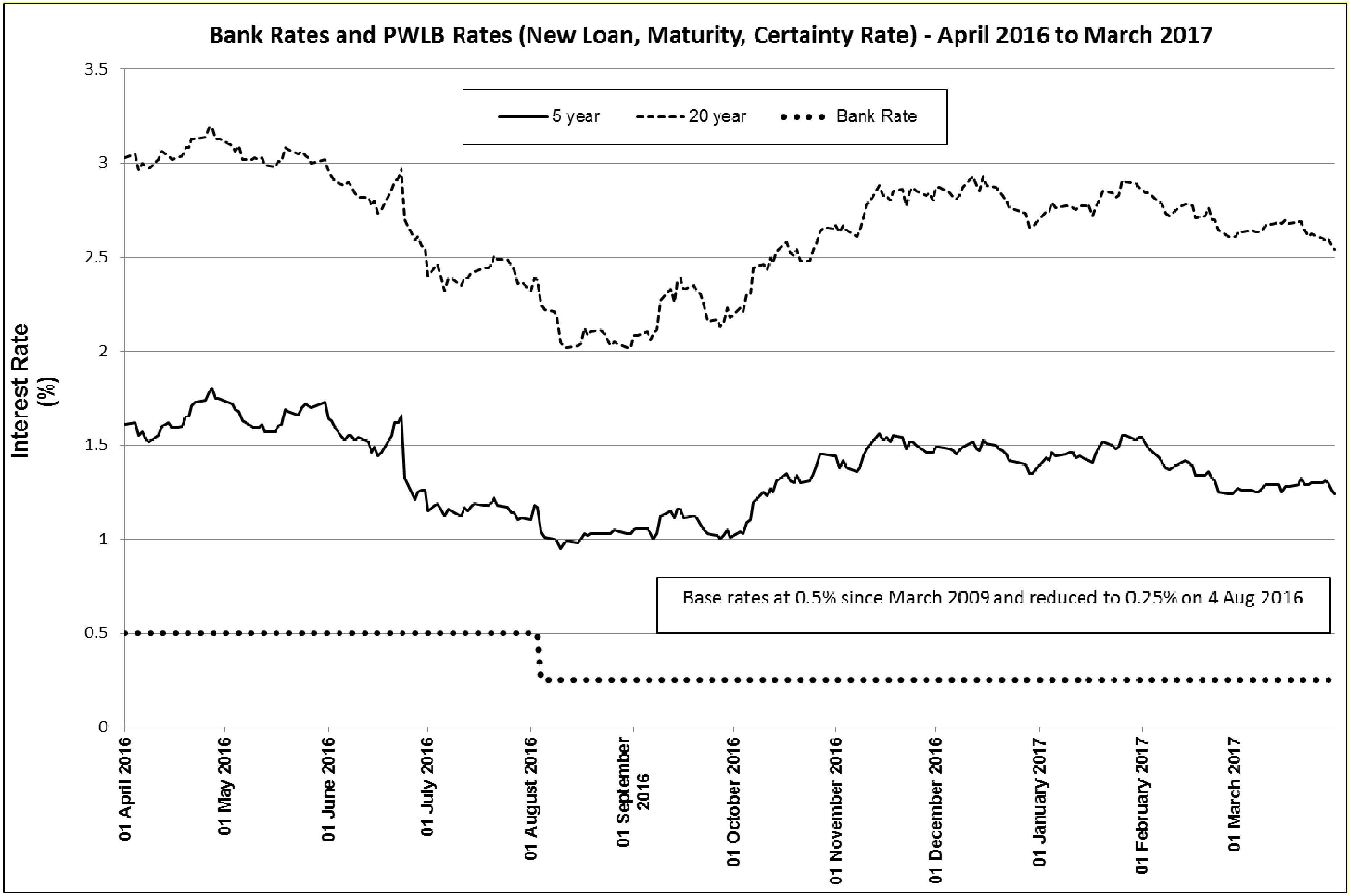
	Budget £’m	Actual £’m	Variation £’m	Narrative
Gross interest payable	152.0	138.5	(13.5)	Interest savings arising from lower than budgeted interest rates, offset by the cost of additional service prudential borrowing not included in original budget
Interest receivable	(0.4)	(0.5)	(0.1)	Interest received on additional investment balances
Revenue charge for debt repayment	120.1	118.4	(1.7)	Reduced HRA debt repayment provision funded from the HRA
Early payment discount - Pension	(2.3)	(2.3)	0.0	
Contributions to (from) reserves	2.0	2.0	0.0	
Other Costs	1.1	0.8	(0.3)	Lower than budgeted Debt Management Expenditure
Total Treasury Management Budget	**272.5**	**257.0**	**(15.6)**	
Less recharges to:				
HRA	(54.2)	(53.1)	1.1	Decrease in MRP
General Fund	(181.4)	(183.7)	(2.3)	Additional prudential borrowing costs not included in original budget
Net Corporate Treasury	**37.0**	**20.1**	**(16.9)**	

9. Prudential Indicators

9.1 At the time of setting the Budget the City Council is required under the Local Government Act 2003 and the CIPFA Prudential Code for Capital Finance in Local Authorities to set various prudential indicators and limits covering capital finance and treasury management. The outturn position against the Council’s approved prudential indicators are attached at Annex 5 and 6. The City Council did not breach any of its prudential limits set under the Local Government Act 2003 and the CIPFA Prudential Code for Capital Finance.

10. Risk management arrangements

10.1 Treasury management activities are regulated by law and under the CIPFA Treasury Management Code. The adequacy of risk control arrangements are tested regularly by internal and external audit. The Treasury Management Policy and Strategy set out policies, limits and strategies for managing treasury risks, which have been reviewed throughout this report.


Bank Rates and PWLB Rates (New Loan, Maturity, Certainty Rate) - April 2016 to March 2017
Interest Rate (%)
3.5
3
2.5
2
1.5
1
0.5
0
5 year
20 year
Bank Rate
Base rates at 0.5% since March 2009 and reduced to 0.25% on 4 Aug 2016
01 April 2016
01 May 2016
01 June 2016
01 July 2016
01 August 2016
01 September 2016
01 October 2016
01 November 2016
01 December 2016
01 January 2017
01 February 2017
01 March 2017

1st April 2016 - 31st March 2017

Annex 2

New Long Term Loans taken out during the year.

Date of loan	Loan	Counter Party	Interest Rate	Maturity Date
16 June 2016	£40m	PWLB	2.56%	16 June 2059

Long Term Loans prematurely repaid during the year.

Date of repayment	Loan/ (Repayment)	Counter Party	Interest Rate	Maturity Date	Premia/ (Discounts)

No long term loans were prematurely repaid during the year.

Annex 3.1

Treasury Management Investment Details
1st January 2017 to 31st March 2017

New Investments Market Fixed Term Deposits

Date Out	Date In	Borrower	Amount £	Interest Rate
No fixed term deposits in this quarter				

In addition to the above deposits with individual institutions the Council uses money market funds and other call accounts where money may be added or withdrawn usually without notice. A summary of transactions for the quarter is as follows:

New Investments Call Accounts

	No of Transactions		Average	Average
	Investments	Withdrawals	Balance £	Rate Earned
Barclays Bank PLC FIBCA A/C	24	24	3,410,833	0.30%
Svenska Handelsbanken	4	8	1,394,444	0.20%
HSBC	6	4	2,163,962	0.30%

New Investments Money Market Funds

	No of Transactions		Average	Average
	Investments	Withdrawals	Balance £	Rate Earned
Aberdeen (SWIP)	5	6	4,427,778	0.27%
Amundi Money Market Fund	11	9	21,228,333	0.33%
Federated Money Market Fund	3	5	2,238,889	0.28%
LGIM	5	8	18,033,333	0.28%
Standard Life (Ignis) Sterling Liquidity	5	6	16,897,778	0.29%

Note
Investment activity in previous quarters has been reported in the relevant quarterly Capital & Treasury Monitoring to Cabinet.

Annex 3.2

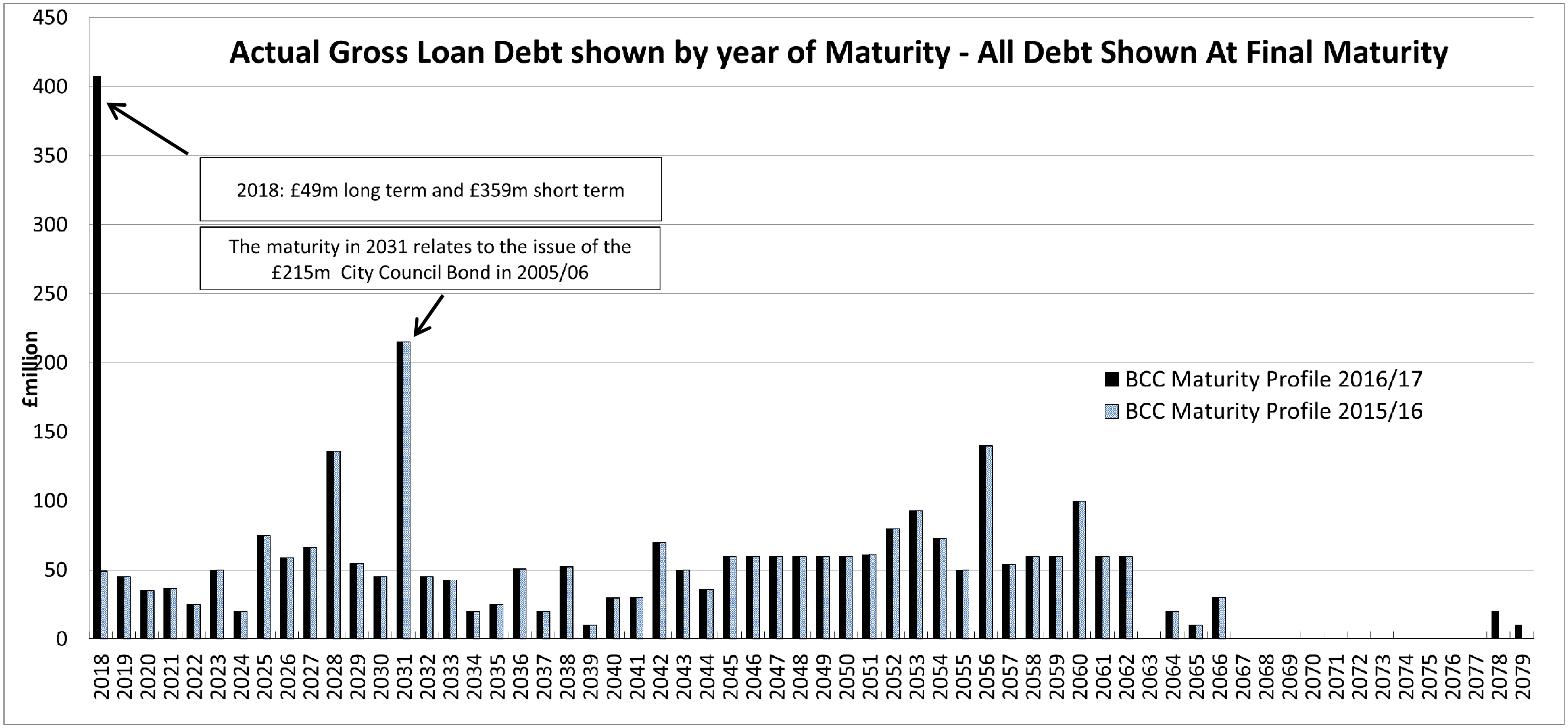
Accountable Body Investments - 31st March 2017

	Growing Places Fund	Advanced Manufacturing Supply Chain Initiative	Regional Growth Fund	**Total**
	£000	£000	£000	£000
Goldman Sachs Money Market Fund	2,981	3,391		**6,372**
JP Morgan Money Market Fund			9,942	**9,942**
Total Money Market Funds	2,981	3,391	9,942	**16,313**
Debt Management Office	10,000	10,000		**20,000**
Treasury Bills	`			**0**
Total Accountable Body investments	**12,981**	**13,391**	**9,942**	**36,313**

Note

This appendix shows amounts invested externally by the City Council as Accountable Body.
These are separate from the Council's own investments.

Annex 4


Actual Gross Loan Debt shown by year of Maturity - All Debt Shown At Final Maturity
2018: £49m long term and £359m short term
The maturity in 2031 relates to the issue of the £215m City Council Bond in 2005/06
£million
BCC Maturity Profile 2016/17
BCC Maturity Profile 2015/16
0
50
100
150
200
250
300
350
400
450
2018
2019
2020
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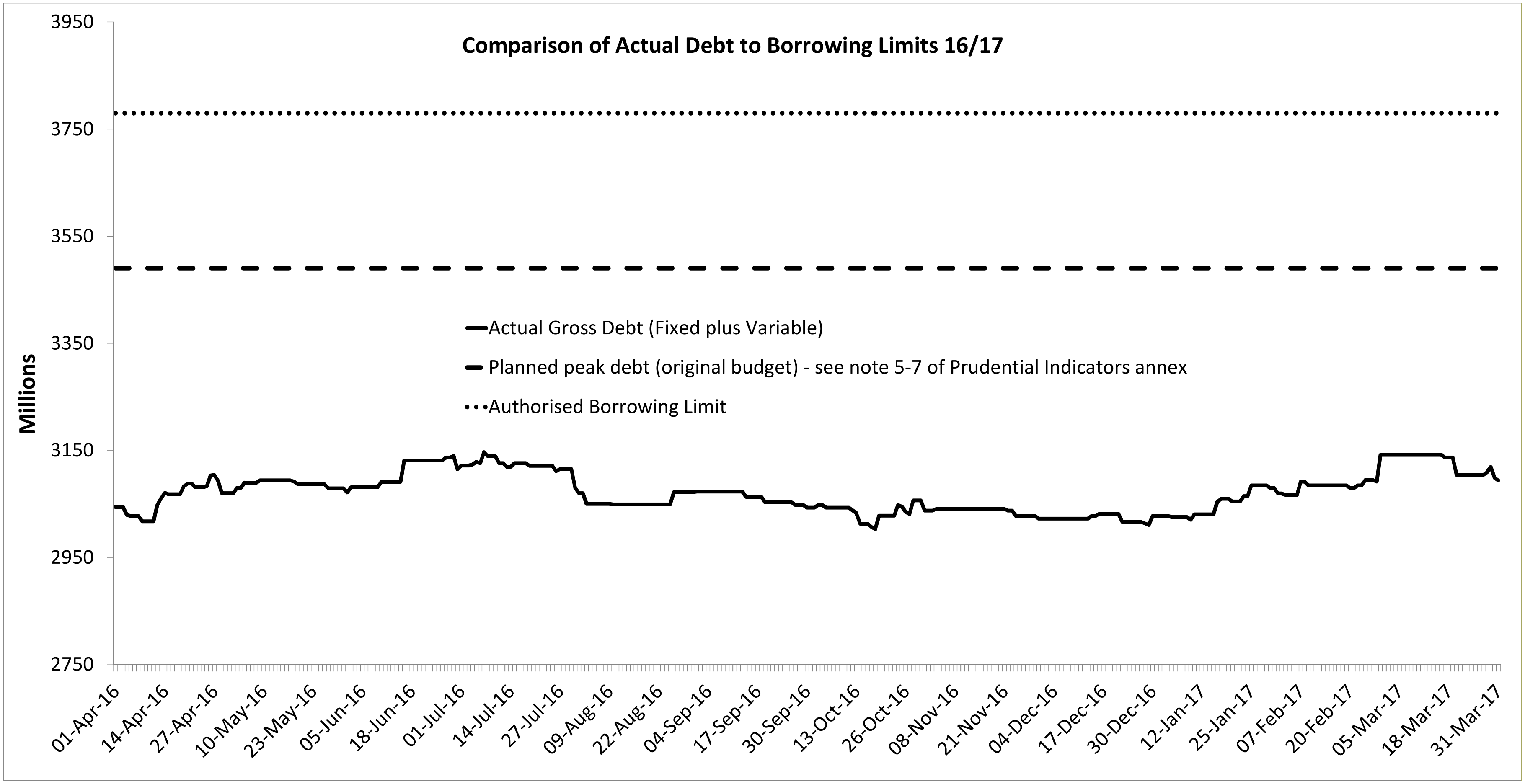
Annex 5


Comparison of Actual Debt to Borrowing Limits 16/17
Millions
3950
3750
3550
3350
3150
2950
2750
Actual Gross Debt (Fixed plus Variable)
Planned peak debt (original budget) - see note 5-7 of Prudential Indicators annex
Authorised Borrowing Limit
01-Apr-16
14-Apr-16
27-Apr-16
10-May-16
23-May-16
05-Jun-16
18-Jun-16
01-Jul-16
14-Jul-16
27-Jul-16
09-Aug-16
22-Aug-16
04-Sep-16
17-Sep-16
30-Sep-16
13-Oct-16
26-Oct-16
08-Nov-16
21-Nov-16
04-Dec-16
17-Dec-16
30-Dec-16
12-Jan-17
25-Jan-17
07-Feb-17
20-Feb-17
05-Mar-17
18-Mar-17
31-Mar-17

DEBT AND PRUDENTIAL INDICATORS Annex 6A

	WHOLE COUNCIL	16/17 Indicators £m	16/17 Outturn £m
	Capital Finance		
1	Capital Expenditure - Capital Programme	451.2	335.4
2	Capital Expenditure - other long term liabilities	27.4	27.0
3	Capital expenditure	478.6	362.3
4	Capital Financing Requirement (CFR)	4,682.6	4,574.6
	Planned Debt		
5	Peak loan debt in year	3,490.5	3,147.0
6	+ Other long term liabilities (peak in year)	492.9	494.6
7	= Peak debt in year	3,983.4	3,641.6
8	does peak debt exceed year 3 CFR?	no	no
	Prudential limit for debt		
9	Gross loan debt	3,780.0	3,147.0
10	+ other long term liabilities	520.0	494.6
11	= Total debt	4,300.0	3,641.6

Notes

4 The Capital Financing Requirement represents the underlying level of borrowing needed to finance historic capital expenditure (after deducting debt repayment charges).This includes all elements of CFR including Transferred Debt.

5-7 These figures represent the forecast peak debt (which may not occur at the year end). The Prudential Code calls these indicators the Operational Boundary.

8 It would be a cause for concern if the Council's loan debt exceeded the CFR, but this is not the case due to positive cashflows, reserves and balances. The Prudential Code calls this Borrowing and the capital financing requirement.

11 The Authorised limit for debt is the statutory debt limit. The City Council may not breach the limit it has set, so it includes allowance for uncertain cashflow movements and potential borrowing in advance for future needs.

DEBT AND PRUDENTIAL INDICATORS Annex 6B

	HOUSING REVENUE ACCOUNT	16/17 Indicators £m	16/17 Outturn £m
	Capital Finance		
1	Capital expenditure	133.5	95.7
	HRA Debt		
2	Capital Financing Requirement (CFR)	1,129.3	1,122.3
3	Statutory cap on HRA debt	1,150.4	1,150.4
	Affordability		
4	HRA financing costs	97.5	100.6
5	HRA revenues	287.0	288.3
6	HRA financing costs as % of revenues	34.0%	34.9%
7	HRA debt : revenues	3.9	3.9
8	Forecast Housing debt per dwelling	£18,056	£18,023
9	Estimate of the incremental impact of new capital investment decisions on housing rents. (expressed in terms of ave. weekly housing rent)	£0.00	£0.00

Notes

2-3 The HRA Capital Financing Requirement (CFR) is being used by the Government as the measure of HRA debt for the purposes of establishing a cap on HRA borrowing for each English Housing

4 Financing costs include interest and MRP (or depreciation in the HRA)

7 This indicator is not in the Prudential Code but is a key measure of long term sustainability. This measure is forecast to fall below 2.0 by 2026/27, which is two years later than previously forecast.

8 This indicator is not in the Prudential Code but is a key measure of affordability: the HRA debt per dwelling should not rise significantly over time

9 The cost of borrowing for the Capital Programme represents the interest and repayment costs arising from any new prudential borrowing introduced in the capital programme since the last quarter, expressed in terms of an average weekly rent. The calculation excludes the cost of borrowing which is funded from additional income or savings. As all planned HRA borrowing is funded from additional income in this way, the impact is zero. The Prudential Code calls this the Estimate of the incremental impact of capital investment decisions on housing rents.

DEBT AND PRUDENTIAL INDICATORS — Annex 6C

	GENERAL FUND	16/17 Indicators £m	16/17 Outturn £m
	Capital Finance		
1	Capital expenditure (including other long term liabilities)	345.1	266.7
2	Capital Financing Requirement (CFR)	3,553.3	3,452.3
	General Fund debt		
3	Peak loan debt in year	2,361.2	2,024.7
4	+ Other long term liabilities (peak in year)	492.9	494.6
5	= Peak General Fund debt in year	2,854.1	2,519.3
	General Fund Affordability		
6	Total General Fund financing costs	261.9	255.4
7	General Fund net revenues	835.3	835.3
8	General Fund financing costs (% of net revenues)	31.4%	30.6%
9	Estimate of the incremental impact of new capital investment decisions on Council Tax.	N/A	£0.00
	Expressed in terms of Council Tax (Band D equiv)		
	(impact already included in Council Tax increases assumed in LTFP)		

Note

4 Other long term liabilities include PFI, finance lease liabilities, and transferred debt liabilities

6 Financing costs include interest and MRP (in the General Fund), for loan debt, transferred debt, PFI and finance leases

8 This indicator includes the gross revenue cost of borrowing and other finance, including borrowing for the Enterprise Zone and other self-supported borrowing.

9 The incremental impact of new capital investment decisions represents the interest and repayment implications arising from any changes in forecast prudential borrowing in the capital programme since the last quarter, expressed in terms of Council Tax at Band D. Any implications are cumulative in later years as succesive years' borrowing is added. Any impact has been funded within the Long Term Financial Plan and assumed Council Tax charges up to 2017/18. The calculation excludes the cost of borrowing which is funded from additional income or savings. All the changes in forecast prudential borrowing relate to self-funding projects, so there is no net incremental impact on Council Tax.

PRUDENTIAL INDICATORS — Annex 6D

	TREASURY MANAGEMENT	16/17 Indicators	16/17 Outturn
	CIPFA Treasury Management Code		
1	Has the authority adopted the TM Code?	Yes	Yes
	Interest rate exposures	**Limit**	**Outturn Maximum**
2	upper limit on fixed rate exposures	130%	96%
3	upper limit on variable rate exposures	30%	14%
4	Gross Debt as a percentage of Net Debt	130%	101%
	Maturity structure of borrowing (lower limit and upper limit)	**Limit**	**Outturn Year End**
5	under 12 months	0% to 30%	14%
6	12 months to within 24 months	0% to 30%	3%
7	24 months to within 5 years	0% to 30%	6%
8	5 years to within 10 years	0% to 30%	9%
9	10 years to within 20 years	5% to 40%	21%
10	20 years to within 40 years	10% to 60%	38%
11	40 years and above	0% to 40%	10%
	Investments longer than 364 days upper limit on amounts maturing in:	**Limit**	**Outturn**
12	1-2 years	200	-
13	2-3 years	100	-
14	3-5 years	100	-
15	later	0	-

Note

2-10 These indicators assume that LOBO loan options are exercised at the earliest possibility, and are calculated as a % of net loan debt.