The Vale of Glamorgan Council

Cabinet Meeting: 25 July, 2016

Report of the Leader

Treasury Management

Purpose of the Report

1. To present to Cabinet the annual review report on Treasury Management 2015/16.

Recommendation

1. That Cabinet accept the annual report on Treasury Management 2015/16 and that the report be referred to Council for approval.

Reason for the Recommendation

1. To accept and refer the report to Council.

Background

2. In March 2012 the Council adopted the 2011 edition of the CIPFA Treasury Management in the Public Services: Code of Practice, which requires the Council to approve a treasury management strategy before the start of each financial year, a mid year report, and an annual report after the end of each financial year.
3. This annual treasury report has been prepared as required and covers:

- the economy / interest rates in 2015/16;
- the strategy for 2015/16;
- the borrowing outturn for 2015/16;
- investment outturn for 2015/16;
- compliance with treasury limits and Prudential Indicators;

The Economy / Interest Rates in 2015/16

4. The following information has been prepared by the Authority's Treasury Management adviser and it sets out the changing conditions under which Treasury Management operations were carried out.
5. The UK economy slowed in 2015 with GDP growth falling to 2.3% from a robust 3.0% the year before. CPI inflation hovered around 0.0% through 2015. The prolonged

spell of low inflation was attributed to the continued collapse in the price of oil, the appreciation of sterling since 2013 pushing down import prices and weaker than anticipated wage growth resulting in subdued unit labour costs. CPI picked up to 0.3% in February, but this was still well below the Bank of England's 2% inflation target. The labour market continued to improve in Q1 2016 with the latest figures (Jan 2016) showing the employment rate at 74.1% (the highest rate since comparable records began in 1971) and unemployment rate at a 12 year low of 5.1%. Wage growth has, however, remained modest at around 2.2% excluding bonuses, but after a long period of negative real wage growth (i.e. after inflation) real earnings were positive and growing at their fastest rate in eight years, boosting consumers' spending power.

6. The slowdown in the Chinese economy became the largest threat to the South East Asian region, particularly on economies with a large trade dependency on China and also to prospects for global growth as a whole. The effect of the Chinese authorities' intervention in their currency and equity markets was temporary and led to high market volatility as a consequence. There were falls in prices of equities and risky assets and a widening in corporate credit spreads. As the global economy entered 2016 there was high uncertainty about growth, the outcome of the US presidential election and the consequences of June's referendum on whether the UK should remain in the EU. Between February and March 2016 sterling depreciated by around 3%, a significant proportion of the decline reflecting the uncertainty surrounding the referendum result.

7. UK Monetary Policy: The Bank of England's MPC (Monetary Policy Committee) made no change to policy, maintaining the Bank Rate at 0.5% (in March it entered its eighth year at 0.5%) and asset purchases (Quantitative Easing) at £375bn. In its Inflation Reports and monthly monetary policy meeting minutes, the Bank was at pains to stress and reiterate that when interest rates do begin to rise they were expected to do so more gradually and to a lower level than in recent cycles.

8. Improvement in household spending, business fixed investment, a strong housing sector and solid employment gains in the US allowed the Federal Reserve to raise rates in December 2015 for the first time in nine years to take the new Federal funds range to 0.25%-0.50%. Despite signalling four further rate hikes in 2016, the Fed chose not to increase rates further in Q1 and markets pared back expectations to no more than two further uplifts this year.

9. However central bankers in the Eurozone, Switzerland, Sweden and Japan were forced to take policy rates into negative territory. The European Central Bank also announced a range of measures to inject sustained economic recovery and boost domestic inflation which included an increase in asset purchases (Quantitative Easing).

10. From June 2015 gilt yields were driven lower by the a weakening in Chinese growth, the knock-on effects of the fall in its stock market, the continuing fall in the price of oil and commodities and acceptance of diminishing effectiveness of central bankers' unconventional policy actions. Added to this was the heightened uncertainty surrounding the outcome of the UK referendum on its continued membership of the EU as well as the US presidential elections which culminated in a significant volatility and in equities and corporate bond yields.

11. 10-year gilt yields moved from 1.58% on 31/03/2015 to a high of 2.19% in June before falling back and ending the financial year at 1.42%. The pattern for 20-year gilts was similar, the yield rose from 2.15% in March 2015 to a high of 2.71% in June

before falling back to 2.14% in March 2016. The FTSE All Share Index fell 7.3% from 3664 to 3395 and the MSCI World Index fell 5.3% from 1741 to 1648 over the 12 months to 31 March 2016.

Treasury Management Strategy 2015/16

12. The Section 151 Officer continued to adopt a cautious approach with respect to Treasury Management operations. The Council's primary objectives for the management of its investments are to give priority to the security and liquidity of its funds before seeking the best rate of return. This being the case the Authority continued to place a significant proportion of its funds with the 'Debt Management Account Deposit Facility' (DMADF) as these deposits are guaranteed by the British Government, although the interest rate is lower than some commercial banks.

13. Funds not placed in the DMADF were placed with other Local Authorities. These investments attract a slightly more favourable rate of return but still give priority to the security of funds invested.

14. The Council's primary objective for the management of its debt is to ensure its long term affordability. The majority of its loans have therefore been borrowed from the Public Works Loan Board (PWLB) at long term fixed rates of interest. In 2015/16 the Council continued to finance a significant proportion of its capital expenditure from internal resources. The potential reduction of the Councils investments balances at times of elevated credit risk was considered the most prudent option available to the Authority at this time.

15. During 2015/16 the Authority borrowed £63.156M from the PWLB to fund the Housing Revenue Account Subsidy buyout. The Housing Revenue Account Subsidy Buyout took place on 2nd April 2015, when the 11 stock retaining councils in Wales took out PWLB loans and paid them over to the Treasury via Welsh Government to buy themselves out of the Housing Subsidy arrangements. The borrowing consisted of 9 individual loans as set out below;

Amount	Final Payment Date	Rate
£5,000,000	15/03/2031	3.96%
£1,155,896	15/03/2032	4.01%
£9,000,000	15/03/2033	4.05%
£8,000,000	15/03/2035	4.13%
£8,000,000	15/03/2037	4.18%
£8,000,000	15/03/2039	4.22%
£8,000,000	15/03/2041	4.24%
£8,000,000	15/03/2043	4.25%
£8,000,000	15/03/2045	4.25%

Under the terms of the agreement the Authority had to borrow from the PWLB using a range of interest rates based on the equivalent 30 year maturity rate being set at 4.25%.by HM Treasury. This was required to achieve a guaranteed amount of interest for HM Treasury to make the buyout viable.

16. Council approved the Treasury Management Strategy for 2015/16 at its meeting on the 4th March 2015, minute no. 938.

17. The Section 151 Officer advises that all treasury management activity undertaken during the financial year complied with the amended approved strategy, the CIPFA Code of Practice, and the relevant legislative provisions.

Borrowing Outturn 2015/16

18. During 2015/16 £7,091,225 of internal funds were used to finance capital expenditure. This included unsupported capital expenditure for 2 new loans, an Education School Investment Programme loan for £74,000 and a Welsh Housing Quality Standard (WHQS) loan for £3,619,225. An average rate of interest was charged to reflect the use of these capital resources. The total charges for interest and principal during the year 2015/16 were £7,915,461 and £6,224,292 respectively. Of this total, charges for interest and principal on unsupported capital expenditure were £3,378,628 and £1,823,192 respectively.

19. With the exclusion of the loans advanced in previous years under the "Local Government Borrowing Initiative" for highways, a borrowing rate of 4.54%, revised down to 4.20% was included in the estimates for 2015-2016. The actual rate was 4.14%.

20. The Council's external debt as at the 31st March 2016 (excluding accrued interest) was £159.411 million (1st April 2015 £96.368 million). This can be summarised as follows:

	Opening Balance 1st April 2015 £'000	**Received** £'000	**Repaid** £'000	**Closing Balance 31st March 2016** £'000
P.W.L.B.	90,266	63,156	(2,211)	151,211
Market Loans	6,000	0	0	6,000
WG Loans	0	2,100	0	2,100
Bonds	2	0	(2)	0
Temporary Loans	100	760	(760)	100
Total	**96,368**	**66,016**	**(2,973)**	**159,411**

- Loans borrowed from the Public Works Loan Board (PWLB) are intended to assist Local Authorities in meeting their longer term borrowing requirements. New loans totalling £63.156 million were borrowed during 2015/16 at rates of between 3.96% and 4.25% as set out above. The average interest rate on all the Authority's outstanding PWLB debt has moved over the course of the year from 5.378% to 4.8204%.

- Market loans represent those non-PWLB loans that are repayable at least 1 year or more from the date they are advanced. The debt is a market loan, £2,000,000 of which will mature on the 8th November 2021 and £4,000,000 will mature on the 23rd February 2054. The average interest rate on the Authority's outstanding market loans is 5.322%

- Local bonds are issued to members of the public who wish to invest in the Authority. There were two bond maturities during 2015/16.

- The Authority has received an interest free loan of £2,100,000 from the Welsh Government (WG) to progress the Barry Island link road project. This loan has yet to be drawn down by the developers.
- Temporary Loans represent loans that have no fixed maturity date. Current loans have been borrowed from The Vale of Glamorgan Welsh Church Act Fund. Interest is calculated on a monthly basis using a combined the "Average 7 Day Rate". The interest rates payable on the Authority’s outstanding temporary loans ranged from 0.48% to 0.55% during 2015/16.

Investment Outturn for 2015/16

21. Internally Managed Investments – The Authority manages investments in-house and is able to invest with those institutions who as a minimum meet the credit rating criteria and therefore would be included in the approved lending list. The Authority can invest short term for a range of periods from overnight to 364 days, dependent on its cash flows, its interest rate view and the interest rates/ periods on offer.
22. Investment movements for 2015/16 (excluding accrued interest) are summarised as follows:-

	Opening Balance 1st April 2015	**Invested**	**Repaid**	**Closing Balance 31st March 2016**
	£’000	£’000	£’000	£’000
Debt Management Account Deposit Facility	51,125	1,520,780	(1,541,305)	30,600
Local Authorities	30,000	110,000	(92,000)	48,000
Total	**81,125**	**1,630,780**	**(1,633,305)**	**78,600**

23. The continuing market uncertainties resulted in the majority of available funds still being invested cautiously either in the Debt Management Account Deposit Facility (DMADF) or with Local Authorities.
24. Debt Management Account Deposit Facility - The Authority placed a significant portion of all surplus funds in the DMADF, which is guaranteed by the British Government. The maturity dates of these investments ranged from overnight to a maximum period of 6 months. The Authority made a return of £122,330 at a rate of 0.25% pa on these investments.
25. Local Authorities - During the year deposits were placed with local authorities. The Authority made a return on these investments of £185,715 at a rate of 0.4285%.
26. The overall return on investments for 2015/16 was 0.3403%.
27. The Section 151 Officer will continue to keep the borrowing / investment strategy under review.

Treasury Limits and Prudential Indicators

28. The Council is asked to note the Prudential Indicators shown in Appendix A.

Resource Implications (Financial and Employment)

29. As set out in this report

Sustainability and Climate Change Implications

30. There are no sustainability and climate change implications.

Legal Implications (to Include Human Rights Implications)

31. As set out in this report

Crime and Disorder Implications

32. There are no crime and disorder implications.

Equal Opportunities Implications (to include Welsh Language issues)

33. There are no equal opportunity implications.

Corporate/Service Objectives

34. Provide sound financial and reliable advice in relation to all issues affecting the Council

Policy Framework and Budget

35. The report will be forwarded to Council for approval

Consultation (including Ward Member Consultation)

36. The appropriate Chief Officers have been consulted on this report. This report does not require Ward Member consultation.

Relevant Scrutiny Committee

37. Corporate Resources

Background Papers

None

Contact Officer

Gemma Jones Principal Accountant

Officers Consulted

All appropriate Chief Officers have been consulted on the contents of this report.

Responsible Officer:

Section 151 Officer