Agenda Item 6

SWANAGE TOWN COUNCIL

Annual Treasury Report 2016/17

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Annual Treasury Report 2016/17

1. Background

The Council's Treasury Management Strategy for 2016/17 is underpinned by having due regard to the Chartered Institute of Public Finance and Accountancy's Guidance for Smaller Public Organisations on the Application of the CIPFA Code of Practice for Treasury Management in the Public Services: Code of Practice 2011 Edition (the CIPFA Code) and the Department for Communities and Local Government (CLG) *Guidance on Local Authority Investments*, issued March 2010. The Code recommends that members approve a treasury management annual report after the end of each financial year.

The Authority's Treasury Management Strategy for 2016/17 was approved by full Council on 18/01/2016 which can be accessed on http://www.swanage.gov.uk/Downloads.aspx.

The Authority 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 Authority's treasury management strategy.

2. External Context

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 Authority'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 Authority'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

At 31/03/2017 the Authority's underlying need to borrow for capital purposes was nil, while usable reserves which are the underlying resources available for investment were £5.95m. At 31/03/2017, the Authority had no borrowing and £5.55m of investments.

4. Borrowing Strategy and Debt Management

The Authority is debt free. The 2016/17 capital expenditure plans and treasury strategy did not imply a need to borrow over the 3-year forecast period. Investments are forecast to fall to £4.7m by March 2020, as capital receipts, earmarked reserves and the general fund are used to finance the capital programme.

5. Investment Activity

The Authority has held significant invested funds, representing reserves held. During 2016/17 the Authority's investment balances have remained relatively stable at around £5.5m throughout the year.

The Guidance on Local Government Investments in England gives priority to security and liquidity and the Authority's aim is to achieve a yield commensurate with these principles.

Table 1: Investment Position

Investments	Balance on 01/04/2015 £	Investments Made £	Maturities/ Investments Sold £	Balance on 31/03/2016 £
Banks and building societies and other organisations - Short-term (minimum rating A-)	2,306,850	960,885	(1,000,149)	2,267,586
AAA-rated Money Market Funds	401,466	1,423	0	402,889
Loans to small businesses / other organisations	0		0	0
Investments in Pooled Funds	2,500,000	0	0	2,500,000
Commercial Paper, Corporate Bonds and other marketable instruments	286,735	379,080	(286,735)	379,080
TOTAL INVESTMENTS	**5,495,051**			**5,549,555**
Increase/(Decrease) in Investments				**54,504**

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.

In furtherance of these objectives, and given the increasing risk and falling returns from short-term unsecured bank investments, the Authority looked to further diversify into more secure and/or higher yielding asset classes during 2016/17. £1.5m that is available for longer-term investment has been earmarked to be moved from bank deposits into pooled bond/equity funds, with a view to reduce risk. Accounts were opened with M & G Investments and Investec Asset Management in 2016/17 with investments pending. The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in table 2 below.

Table 2: Investment Benchmarking

Date	Credit Score	Credit Rating	Bail-In Exposure	No. of Counterparties/ Funds	Rate of Return (income only)
31/03/2016	5.36	A+	90%	7	3.01%
30/06/2016	5.25	A+	90%	7	2.97%
30/09/2016	4.65	A+	79%	7	2.77%
31/12/2016	4.65	A+	87%	6	2.60%
31/03/2017	4.69	A+	88%	6	2.49%

The Authority's best performing investment in 2016/17 was its £2.5m (book value, £3.037m net asset value) of externally managed pooled property funds. This generated an income return of £138,920 (5.55% of book value, 4.57% of net asset value) used to support services in year. It also saw a £48,000 or 1.56% reduction in its net asset value year on year due to a revaluation of the fund following the referendum result. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives is regularly reviewed. In light of their strong performance and the Authority's latest cash flow forecasts, investment in these funds has been maintained for the 2017/18 financial year.

6. Compliance

The Council can confirm that it has complied with its Annual Investment Strategy which was approved as part of the Council's Treasury Management Strategy Statement 2015/16 to 2017/18.

Annual Treasury Report 2016/17

This report provides members with a summary report of the treasury management activity during 2016/17, having due regard to both the CIPFA Code of Practice and the CLG Guidance. A prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.

The Authority can confirm that during 2016/17 it complied with its **Treasury Management Policy Statement** and **Treasury Management Practices**.

7. Other Items

Investment Training: The needs of the Authority's treasury management staff for training in investment management are assessed as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change.

During 2016/17 staff attended strategy meetings and training courses with Arlingclose.