Somerset County Council

Cabinet
– 10th July 2017

Annual Treasury Management Outturn Report 2016-17

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Division and Local Member: All
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Report Sign off	**Seen by:**	**Name**	**Date**
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	Senior Manager	Kevin Nacey	12/6
	Cabinet Member	David Hall	
Forward Plan Reference:	FP/17/04/07		
Summary:	The Annual Treasury Management Outturn Report is a requirement of the CIPFA Treasury Management Code and covers the Treasury Management activity for 2016-17. This report: - ➢ Is prepared in accordance with the CIPFA Treasury Management Code and the Prudential Code. ➢ Gives details of the outturn position on treasury management transactions in 2016-17. ➢ Presents details of capital financing, borrowing, and investment activity. ➢ Reports on the risk implications of treasury decisions and transactions. ➢ Confirms compliance with treasury limits and Prudential Indicators or explains non-compliance.		
Recommendations:	This is a formal report and the Cabinet is asked to approve it and submit it to Full Council on 19th July 2017.		
Reasons for Recommendations:	The Local Government Act 2003 requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services. The Code requires Full Council to receive as a minimum, an annual strategy and plan in advance of the year, a mid-year review, and an annual report after its close. This is the full-year review for 2016-17.		
Links to Priorities and Impact on Service Plans:	Effective Treasury Management provides support to the range of business and service level objectives that together help to deliver the Somerset County Plan.		

Consultations undertaken:	Not Applicable
Financial Implications:	None directly
Legal Implications:	None
HR Implications:	None
Risk Implications:	There are no specific risks associated with this outturn report. The risks associated with Treasury Management are dealt with in the Annual Treasury Management Strategy, Annual Investment Strategy, and Treasury Management Practice documents.
Other Implications (including due regard implications):	None
Scrutiny comments / recommendation (if any):	The Audit Committee is the nominated body to provide scrutiny for Treasury Management and this report will be sent to Audit Committee members.

1. Background

1.1. The Council's treasury management activities are regulated by a variety of professional codes, statutes and guidance. A more detailed outline of these, including the Treasury Management Framework and Policy is given at appendix A.

1.2. Somerset County Council (SCC) has adopted the CIPFA Code of Practice for Treasury Management in the Public Sector Revised 2011 Edition and operates its treasury management service in compliance with this Code and the requirements in appendix A. The Code requires as a minimum, a formal report on treasury activities and arrangements to Full Council mid-year and after the year-end. These reports enable those tasked with implementing policies and undertaking transactions to demonstrate they have properly fulfilled their responsibilities, and enable those with ultimate responsibility/governance of the treasury management function to scrutinise and assess its effectiveness and compliance with policies and objectives.

1.3. Whilst headline figures can be a useful guide to performance, they should not be viewed in isolation. It is important to also assess performance against the stated objectives and specific needs of SCC during the year, and to take a wider view in relation to timeframes and overall risk management. There are many factors and circumstances that affect treasury activity and performance that are not immediately apparent from statistical reports. Activities undertaken may be directly attributable to good risk management or preferred risk tolerances. Some limitations to purely statistical analysis are outlined in appendix B.

1.4. CIPFA Treasury Management Benchmarking Club produces detailed reports of Local Authority performance, and also compares with other authorities. Whilst these headline figures have been a useful guide in assessing performance in the past, it has been equally important to assess performance against the stated objectives and specific needs of SCC during the year, and to take a wider view in relation to timeframes and overall risk management.

In view of the declining numbers that had been using the service, the increasing difficulty of straightforward comparison, and the cost of membership of the Benchmarking Club, it was decided not to participate from 2016-17 forward.

The number of Authorities using the benchmarking club has reduced over the past few years. In 2009-10 there were 136 participants, 95 in 2010-11, 84 in 2011-12, 68 in 2012-13, 50 in 2013-14, and 41 in 2014-15.

Many Authorities are using more esoteric means of 'investing' cash making it increasingly difficult to compare levels of risk tolerance, as well as returns.

2. Treasury Activity and Outturn

2.1. Summary of Performance

During the year, Council treasury management policies, practices, and activities remained compliant with relevant statutes and guidance, namely the CLG investment guidance issued under the Local Government Act 2003, the CIPFA Code of Practice for Treasury Management.

The Council can confirm that it has complied with its Prudential Indicators for 2016-17, with the exception of one band within the Maturity Structure of Borrowing Indicator. This is a technical breach as it was not due to Treasury activity, but was due to the fact that the £57.5m of Barclays LOBOs have become fixed-term loans. Prudential guidance treats this differently, and the loans have moved between bands intra-year. The higher limit on loans maturing between 30-40 years was set at 20%, but reached 26.3% in June as the £57.5m loans moved to that band.

All Capital projects were funded from Capital Receipts and Grant allowances from central Government, thereby eliminating the need to borrow in 2016-17.

The SCC weighted average rate paid on total borrowings was 4.66%, the same as 2015-16 as there was no change in portfolio.

Security of capital remained the Council's main investment objective. This was achieved by following the counterparty policy as set out in the Annual Investment Strategy, and by the approval method set out in the Treasury Management Practices. SCC has continuously monitored counterparties, and all ratings of proposed counterparties have been subject to verification on the day, immediately prior to investment.

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. The negative effects soon unwound, meaning an even more risk-averse stance was not necessary.

However, new investments with Standard Chartered Bank were suspended in March 2016 due to its' relatively high credit default swap (CDS) level and disappointing 2015 financial results. The Council's two deposits with Standard Chartered at that time, matured in July and August 2016. Standard Chartered was reintroduced to the counterparty list in March 2017 following its strengthening financial position, and significant reduction in its' CDS price. An account of issues and any restrictions implemented throughout the year can be found in appendix G.

Liquidity. In keeping with the CLG guidance, the Council maintained a sufficient level of liquidity through the use of call accounts, Money Market Funds, and short-term deposits. SCC did not need to borrow short-term money during the year.

Yield. Total interest of £2.08m was earned during 2016-17. When compared to the average 6-month risk-free deposit rate of approximately 0.13% offered by the Government Debt Management Office (DMO) throughout the year, the benefit of the SCC investment strategy across the average SCC investment balance of £285.5m for the year was just over £1.7m (£1.57m in 2015-16).

Security and liquidity have been achieved with the return of 0.73% achieved for the year being 3 basis points above the average 12-month LIBID rate.

On 8th November 2016, SCC received a fourteenth dividend, £51,574.66 from Kaupthing, Singer & Friedlander. A total of £8,690,329.82 has been received to that date.

In total, as at 31st March 2017 £23,086,582.66 had been recovered on all Icelandic claims. More detail of the current position is in Appendix G.

2.2. 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 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.

In addition to the political fallout, the referendum's outcome also prompted a sharp 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 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 recovering from an initial sharp drop in Quarter 2, 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.

Lending rates for all periods moved significantly in August, in response to the unexpected bank base rate reduction. Average 3-month, 6-month and 12-month LIBID rates decreased by 0.14%, 0.15%, and 0.20% respectively during 2016-17, ending the year at 0.22%, 0.37% and 0.61% lower than in 2015-16.
A more detailed commentary on the year's events is in Appendix C.

2.3. The Portfolio Position as at 31st March 2017

The portfolio position as at 31st March 2017 and a comparison with the beginning of the year can be found in Appendix D.

2.4. Temporary Borrowing

Temporary borrowing has not been necessary at all during 2016-17. Further details can be found in Appendix E.

2.5. Long-Term Borrowing

The overall level of borrowing remained the same during the year, at £329.55m. The cost of rescheduling or repaying PWLB debt early varied significantly during the year as Gilt yields fell yet again. In March 2016 the total premium stood at £79m. During 2016-17, a year-high premium of £130m would have been payable in August, ending the year in March at £103m. Any decision to reschedule or repay debt would need to be taken in this dynamic environment. The weighted average rate paid on all debt was 4.66%. All details of long-term borrowing activity during the year can be found in Appendix F.

2.6. Cash managed on behalf of others

During 2016-17 SCC provided treasury management services to the Police and Crime Commissioner for Avon and Somerset, after winning a full competitive tender to provide Treasury Management services for 3 years from April 2015. Funds continue to be lent on a segregated basis, with PCC funds lent in its own name.

SCC continues to manage cash on behalf of other not-for-profit organisations including Exmoor National Park Authority (ENPA), and the South West Regional Board (SWRB) via service level agreements and the Comfund vehicle. These balances were just over £9.6m at year-end.

In addition, during 2016-17, SCC was retained to manage the Local Enterprise Partnership (LEP) Growth Deal Grant on behalf of the other Enterprise Partners. A grant of £56.7m was received on 11th April 2016.

All treasury management activities, including a fee for the management of the LEP money, brought in income and benefits of approximately £206,000 during the year.

2.7. Lending

The average daily balance of the Council's cash during 2016-17 was £285.5m, down £27.4m from the previous year.

The weighted investment return of 0.73% was 0.03% better than the average 12-Month LIBID rate for the financial year. A more detailed commentary on activity and analysis of performance for the year can be found in Appendix G.

2.8. Comparison against other Local Authorities clients of Arlingclose

2016-17 was the eighth complete year that SCC had the services of retained Treasury advisors, Arlingclose. It would therefore seem appropriate to look at SCC performance compared with other Authorities that use Arlingclose, i.e. that share much of the same investment advice, particularly regarding counterparties. However, many of the caveats mentioned in appendix B may apply. Furthermore, it has become apparent that many Authorities currently have exposure to Property Funds in their Treasury portfolios. With this in mind, a more equitable comparator, figures for internally managed investments only, has been used. The Arlingclose report compares quarter-end figures only, and comparisons can be seen below.

	Average Rate		Average Balance	
	SCC	Others	SCC	Others
June 2015	0.83%	0.69%	£299m	£65m
September 2015	0.73%	0.60%	£282m	£64m
December 2015	0.69%	0.52%	£242m	£62m
March 2016	0.68%	0.61%	£218m	£55m
Average	**0.73%**	**0.61%**	**£260m**	**£62m**

Using this methodology, SCC performance has been above that of comparators. This has been achieved with an average investment balance of more than 4 times that of the average for the universe.

From a risk perspective, both SCC and Other Authorities' average credit rating score was AA- throughout the year. (To give this some perspective, the United Kingdom Government is rated one notch above at AA). This performance relative to risk can be seen in two graphs along with more general detail in appendix G.

2.9. Prudential Indicators

The Council can confirm that it has complied with its Prudential Indicators for 2016-17, with the exception of one band within the Maturity Structure of Borrowing Indicator. This is a technical breach as it was not due to Treasury activity, but was due to the fact that the £57.5m of Barclays LOBOs have become fixed-term loans. Prudential guidance treats this differently, and the loans have moved between bands intra-year. The higher limit on loans maturing between 30-40 years was set at 20%, but reached 26.3% in June as the £57.5m loans moved to that band. Indicators that were set for the 2016-17 year, and the year-end position for each are set out in Appendix H.

2.10. Risk Management

SCC has continuously monitored counterparties, and all ratings of proposed counterparties have been subject to verification on the day, immediately prior to investment. Other indicators taken into account have been:-

- Credit Default Swaps and Government Bond Spreads.
- GDP and Net Debt as a Percentage of GDP for sovereign countries.
- Likelihood and strength of Parental Support.

- Banking resolution mechanisms for the restructure of failing financial institutions i.e. bail-in.
- Share Price.
- Market information on corporate developments and market sentiment towards the counterparties and sovereigns.

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 Council'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.

New investments with Standard Chartered Bank were suspended in March 2016 due to its' relatively high credit default swap (CDS) level and disappointing 2015 financial results. The Council's two deposits with Standard Chartered at that time, matured in July and August 2016. Standard Chartered was reintroduced to the counterparty list in March 2017 following its strengthening financial position, and significant reduction in its' CDS price.

At year-end maximum durations per counterparty were as follows: -

- Nat West & RBS – **35 days;**
- Barclays, Goldman Sachs International, and Standard Chartered – **100 days;**
- Nationwide BS, Santander UK, OP Corporate, Landesbank Hessen-Thuringen and all Australian banks – **6-months;**
- HSBC, Bank of Scotland, Lloyds, Nordea, Rabobank, Svenska Handelsbanken, and all Canadian and Singaporean banks – **13-months;**

There was no audit during 2016-17, so the Audit report dated 28th September 2015 was the last one. It awarded the best possible outcome, as quoted below.

> "I am able to offer substantial assurance as the areas reviewed were found to be adequately controlled. Internal controls are in place and operating effectively and risks against the achievement of objectives are well managed".

SCC has continuously proactively assessed and implemented mitigation for the risks that have materialised in the new investment environment.
Controls/procedures are constantly being assessed and introduced/adapted where needed, and embedded into practices to further mitigate risks to SCC investment and borrowing portfolios.

Details of risk management and governance can be found in Appendix I.

Arlingclose has been retained Treasury Advisors throughout the period.

During the year Treasury staff have continued to attend regular courses and seminars provided through its membership of the CIPFA Treasury Management Forum (TMF), its advisors, Arlingclose, and other ad hoc events including treasury software supplier forums.

3. Options considered and reasons for rejecting them

3.1. Not Applicable

4. Consultations undertaken

4.1. None

5. Financial, Legal, HR and Risk Implications

5.1. There are no direct financial implications arising from this paper. There are no Legal, HR, or other direct risk implications from this report.

6. Other Implications

6.1. None

7. Background papers

7.1. Treasury Management Strategy Statement 2016-17 and appendices. These were approved by Full Council at the meeting on 17th February 2016. The full papers can be found under the 8th February 2016 Cabinet meeting at

http://www1.somerset.gov.uk/council/board3d/Paper%20F%20Treasury%20Management%20Strategy.pdf

http://www1.somerset.gov.uk/council/board3d/Paper%20F%20Treasury%20Management%20Strategy%20Appendix%20A.pdf

http://www1.somerset.gov.uk/council/board3d/Paper%20F%20Treasury%20Management%20Strategy%20Appendix%20B.pdf

http://www1.somerset.gov.uk/council/board3d/Paper%20F%20Treasury%20Management%20Strategy%20Appendix%20C.pdf

http://www1.somerset.gov.uk/council/board3d/Paper%20F%20Treasury%20Management%20Strategy%20Appendix%20D.pdf