REPORT TO AUDIT COMMITTEE

Type of Report: Statutory	**Portfolio(s):** Performance and Leader
Will be subject to a future Cabinet Report: **YES**	
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OPEN	

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ANNUAL TREASURY OUTTURN REPORT 2015/2016

Summary
The Council has formally adopted the Chartered Institute of Public Finance and Accountancy's Code of Practice on Treasury Management (2009) and remains fully compliant with its requirements.

This Annual Treasury Outturn Report looks backwards at 2015/2016 and covers:

1. The 2015/2016 Treasury Outturn
2. Compliance with Treasury Limits
3. Outturn Summary
4. Implications of the Brexit Vote

Additional supporting information:

Appendix 1 - Investments as at 31st March 2016
Appendix 2 - Borrowing as at 31st March 2016
Appendix 3 - Prudential Indicators
Appendix 4 - Treasury Benchmarking Group
Appendix 5 - The Economy 2015/2016

The Council's Treasury Policy Statement 2015/2016 and annual Treasury Strategy Statement 2015/2016 was approved by Cabinet on the 3 March 2015.
A copy of which can be found here: [Documents for Cabinet 3rd March, 2015]

Recommendations
Audit Committee is asked to note the actual treasury outturn 2015/2016.

Reason for the Decision
The Council must make an annual review of its Treasury operation for the previous year, as part of the CIPFA code of Practice.

1. The 2015/2016 Treasury Outturn

1.1 The Chartered Institute of Public Finance and Accountancy (CIPFA) and the Council's Code of Practice on Treasury Management require that the Audit Committee consider an Annual Treasury Outturn Report.

1.2 During the year the Council maintained a cautious approach to investment and management of debt.

1.3 The Councils portfolio position as at 31 March 2016 was:

	31 March 2015 Actual £million	31 March 2016 Actual £million
Borrowing	13.40	17.20
Investments	(26.63)	(28.30)
Net Position	**(13.23)**	**(11.10)**

1.4 During 2015/2016 investments returned at an average return of 1.19%. This exceeding the 7 day LIBID (London Inter Bank Bid Rate) benchmark rate which was 0.36% and the 'Treasury Benchmarking Group' which was 0.87%.

Details of the 'Treasury Benchmarking Group' can be found in *Appendix 4*

Budgeted Interest Receivable	Actual Interest Received
(£288,000)	(£379,459)

1.5 During 2015/2016 interest on external debt was paid at an average rate of 2.72%.

Budgeted Interest Payable	Actual Interest Paid
£465,000	£492,155

Details of the investment portfolio as at the 31 March 2016 can be found in *Appendix 1*

Details of the borrowing portfolio as at the 31 March 2016 can be found in *Appendix 2*

2. Compliance with Treasury Limits

2.1 During the financial year the Council operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Policy Statement 2015/2016 and annual Treasury Strategy Statement 2015/2016. The outturn for the Prudential Indicators is shown in *Appendix 3*.

3. Outturn Summary - In summary the Council:

3.1 Did not pursue any debt rescheduling as long term loans were reviewed against future long term rates and early repayment penalties.

3.2 Took advantage of higher business reserve account rates on short term investments, and tied in rates for fixed term investments to take advantage of higher interest rate returns (while bank rate remained at 0.50%).

3.3 Ensured counterparty listings on our lending lists were maintained and updated regularly, and reported in monthly monitoring reports as necessary.

3.4 Ensured priority was given to security and liquidity in order to reduce counterparty risk. This was achieved by adopting Sector's methodology of using ratings from three agencies to provide the core element of the credit watch service with outlooks and credit default swaps spreads to give early warning signs of changes, and sovereign ratings to select counterparties.

3.5 Undertook benchmarking with other local Councils to ensure that experiences were shared and investment instruments were consistent, while maintaining good credit quality and security *(Appendix 4)*.

4 Implications of the Brexit Vote

4.1 Due to the unprecedented financial conditions resulting from the 'Brexit Vote' on the 23 June 2016 it is considered prudent to review the 2016/2017 investment strategy. Separate report to Cabinet on the 2 August 2016.

4.2 Officers advised by Capita Asset Services will continue to monitor the situation closely and act accordingly.

4.3 For further information on economic conditions during 2015/2016 and the credit Implications of the Brexit Vote please see *Appendix 5*

APPENDIX 1 - Investments as at 31st March 2016:

Institution	Principal	Start Date	End Date	Rate %	Ratings
Natwest (RBS)	2,000,000	28/04/2014	30/08/16	1.68	A
Bank of Scotland	2,000,000	13/04/2015	13/04/2016		A
Natwest (RBS)	2,500,000	22/05/2015	22/05/2017	1.33	A
Fife Council	3,000,000	12/11/2015	13/11/2017		A
Santander	5,000,000	10/12/2015		1.15	A
Goldman Sachs International Bank	2,000,000	04/01/2016	04/07/2016	0.59	A
Qatar NB	3,000,000	01/06/2015	01/06/2016		A
Wyre Forest District Council	2,000,000	14/07/2014	14/07/2016	0.95	AAA
Newcastle City Council	2,000,000	04/08/2014	04/08/2016	1.00	AAA
Cheshire West & Chester Council	2,000,000	20/01/16	19/01/2018	0.99	AAA
BNP (Banque Nationale de Paris) – Money Market Fund	300,000	15/03/16		0.51	AAA
Total Investments	**25,800,000**			**1.14**	
Norfolk & Waveney Enterprise Services (LEP)***	500,000	27/03/2014	30/11/2018	1.80	AAA
Norfolk & Waveney Enterprise Services (LEP)***	274,275	27/03/2015	30/11/2018	1.80	AAA
Norfolk & Waveney Enterprise Services (LEP)***	339,864	29/06/2015	30/11/2018	1.80	AAA
Norfolk & Waveney Enterprise Services (LEP)***	539,865	04/09/2015	30/11/2018	1.80	AAA
Norfolk & Waveney Enterprise Services (LEP)***	240,616	18/09/2015	30/11/2018	1.80	AAA
Norfolk & Waveney Enterprise Services (LEP)***	233,795	28/10/2015	30/11/2018	1.80	AAA
Norfolk & Waveney Enterprise Services (LEP)***	371,585	02/12/2015	30/11/2018	1.80	AAA
Total NWES Investments	**2,500,000**			**1.80**	
Total Overall Investments	**28,300,000**			**1.19**	

***see also Appendix 2 borrowings from Suffolk County Council

The benchmark rate is derived from the 7 day LIBID (London Interbank Bid Rate) rate. The Council exceeded this rate, as investments were tied in for longer periods to take advantage of higher interest returns while the bank rate remained at 0.50%.

APPENDIX 2 - Borrowing as at 31st March 2016:

Start Date	End Date	Loan No	Value £	Institution	Rate	Term
21.03.16	15.04.16	3795	4,000,000	Greater Manchester Pension Fund	0.52%	Short Term - fixed
Total Short Term			**4,000,000**			
22.03.07	21.03.77	5888	5,000,000	Barclays – fixed rate LOBO (lenders option, borrowers option)	3.81%	Long Term – fixed for initial 10 year period, and option to change every 5 years thereafter
12.04.07	11.04.77	5887	5,000,000	Barclays – fixed rate LOBO (lenders option, borrowers option)	3.81%	Long Term - fixed for initial 10 year period, and option to change every 5 years thereafter
15.09.09	14.09.19	495951	700,000	PWLB	2.92%	Long Term – fixed for 10 years
27.03.14	30.11.18	3789	2,500,000	Suffolk County Council (LEP)	1.80%	**see note below
Total Long Term			**13,200,000**			
Total Borrowing			**17,200,000**		**2.72%**	

**A loan was taken out, on behalf of Norfolk and Waveney Enterprise Services Ltd (NWES), with Suffolk County Council for the Local Enterprise Partnership. A corresponding investment is shown in Appendix 1 with NWES at the same rate of interest (£500,000 drawn down in 2013/2014, a further £274,275 followed in 2014/2015, with the remainder in 2015/2016).

APPENDIX 3: Prudential Indicators

PRUDENTIAL INDICATOR	2014/2015 Actual £'000	2015/2016 Actual £'000
Capital Expenditure	8,894	11,218
Ratio of financing costs to net revenue stream	2.91%	2.24%
Net borrowing		
brought forward 1 April	16,600	13,400
carried forward 31 March	13,400	17,200
Change in year	(3,200)	3,800
Net Investment		
brought forward 1 April	31,335	26,625
carried forward 31 March	26,625	28,300
Change in year	4,710	(1,675)

Capital Financing Requirement

The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's debt position. The CFR results from the capital activity of the Council and what resources have been used to pay for the capital spend. It represents the 2015/2016 unfinanced capital expenditure, and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources

CFR	31 March 2015 Actual £000's	31 March 2016 Actual £000's
Opening Balance	14,783	18,590
Add unfinanced capital expenditure	4,933	582
Less MRP	325	306
Less voluntary/additional MRP	753	863
Less finance lease repayments (where the Council is the lessor)	48	15
Closing CFR	**18,590**	**17,988**

Net borrowing and the CFR

In order to ensure that borrowing levels are prudent over the medium term the Council's external borrowing, net of investments, must only be for a capital purpose. This essentially means that the Council is not borrowing to support revenue expenditure. Net borrowing should not therefore, except in the short term, have exceeded the CFR for 2015/2016 plus the expected changes to the CFR over 2016/17 and 2017/18. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allowed the Council some flexibility to borrow in advance of its immediate capital needs in 2015/2016. The table below highlights the Council's net borrowing position against the CFR. The Council has complied with this prudential indicator.

CFR	31 March 2015 Actual £million	31 March 2016 Actual £million
Borrowing	13.40	17.20
Investments	26.63	28.30
Net Position	**(13.23)**	**(11.10)**
Closing CFR	**18.60**	**17.99**

Actual financing costs as a proportion of net revenue stream

This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream (Council Tax and Government Grant).

	2015/2016
Authorised limit	£35m
Maximum gross borrowing position	£17.2m
Operational boundary	£30m
Average gross borrowing position	£13.4m
Financing costs as a proportion of net revenue stream	2.24%

TREASURY MANAGEMENT PRUDENTIAL INDICATORS	2014/2015 £'000	2015/2016 £'000
Authorised limit for external debt -		
Borrowing	30,000	35,000
Operational boundary for external debt -		
Borrowing	25,000	30,000
Upper limit for fixed interest rate exposure		
Net principal re fixed rate borrowing /investments	30,000	35,000
Upper limit for variable rate exposure		
Net principal re variable rate borrowing / investments	25,000	25,000

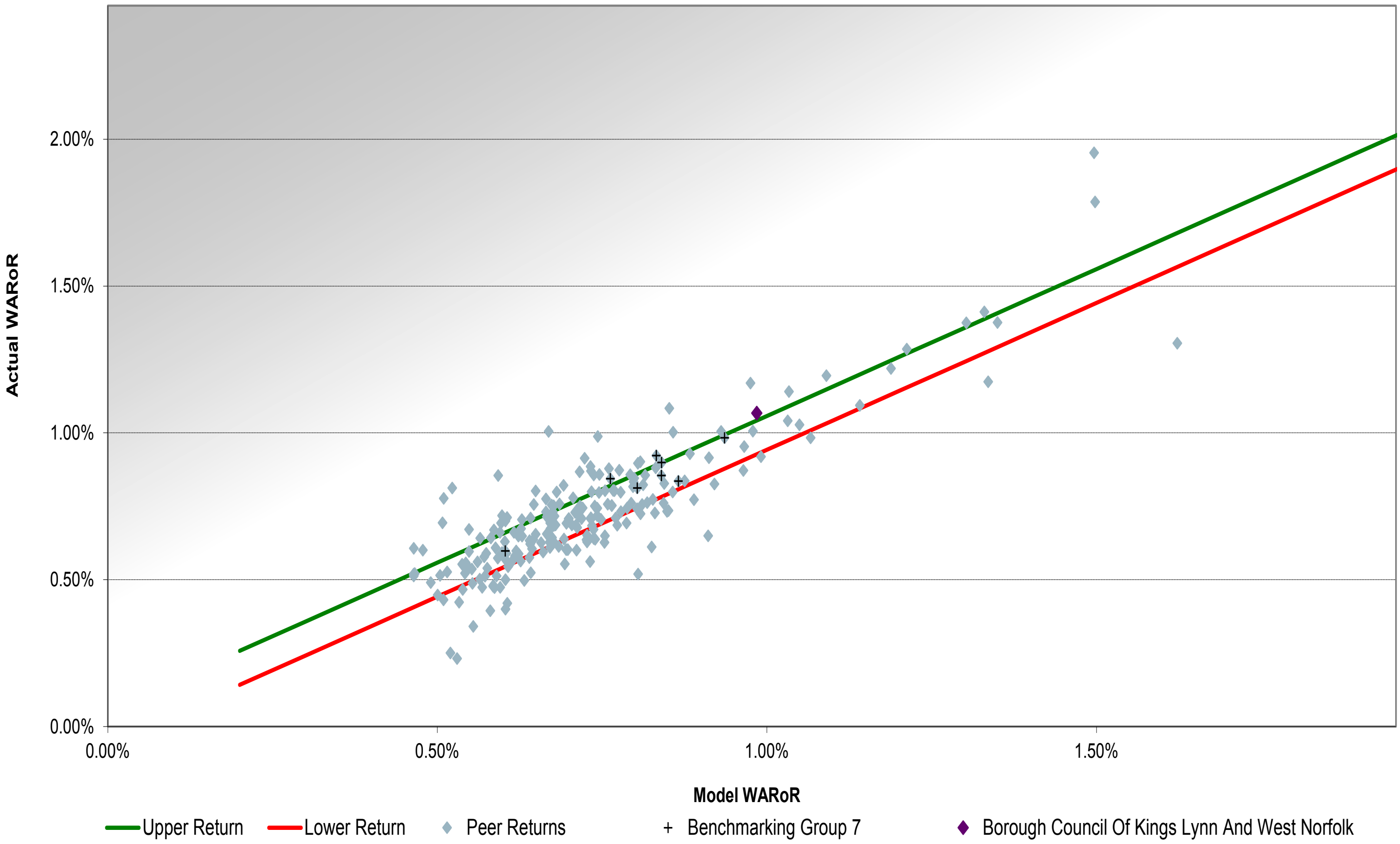
Maturity structure of fixed rate borrowing during 2015/2016	upper limit	lower limit
under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%

APPENDIX 5: Treasury Benchmarking Group

The Council is also a member of a Treasury Benchmarking Group, where Capita Treasury clients from neighbouring authorities (including those in Norfolk, Suffolk and Cambridgeshire) meet to discuss treasury instruments relevant to their authority and discuss ideas for borrowing and investments.

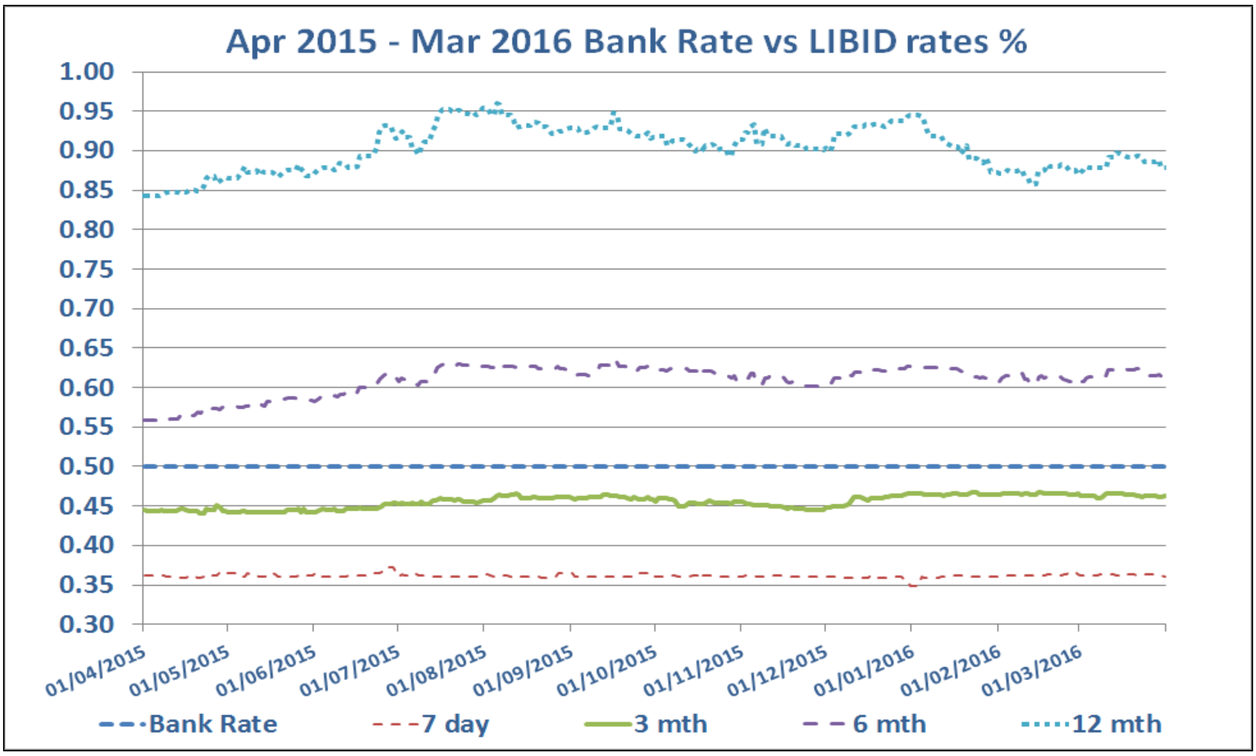
All authorities want to try to maximise their returns, whilst maintaining good credit quality and security during the difficult financial climate. In addition to this, percentage rate returns are disclosed at each quarterly meeting.

The Councils return of 1.14% is the highest return for the last quarter against the group with the average return being 0.87%.



APPENDIX 4: The Economy 2015/2016
Investment Rates in 2015/2016

Bank Rate remained at its historic low of 0.50% throughout the year; it has now remained unchanged for seven years.



Market expectations for the first increase in Bank Rate moved considerably during 2015/16, starting at quarter 3 2015 but soon moving back to quarter 1 2016. However, by the end of the year, market expectations had moved back radically to quarter 2 2018 due to many fears including concerns that China's economic growth could be heading towards a hard landing; the potential destabilisation of some emerging market countries particularly exposed to the Chinese economic slowdown; and the continuation of the collapse in oil prices during 2015 together with continuing Eurozone growth uncertainties.

These concerns have caused sharp market volatility in equity prices during the year with corresponding impacts on bond prices and bond yields due to safe haven flows. Bank Rate, therefore, remained unchanged at 0.5% for the seventh successive year. Economic growth (GDP) in the UK surged strongly during both 2013/14 and 2014/15 to make the UK the top performing advanced economy in 2014. However, 2015 has been disappointing with growth falling steadily from an annual rate of 2.9% in quarter 1 2015 to 2.1% in quarter 4.

The Funding for Lending Scheme, announced in July 2012, resulted in a flood of cheap credit being made available to banks which then resulted in money market investment rates falling materially. These rates continued at very low levels during 2015/16.

The sharp volatility in equity markets during the year was reflected in sharp volatility in bond yields. However, the overall dominant trend in bond yields since July 2015 has been for yields to fall to historically low levels as forecasts for inflation have repeatedly been revised downwards and expectations of increases in central rates have been pushed back. In addition, a notable trend in the year was that several central banks introduced negative interest rates as a measure to stimulate the creation of credit and hence economic growth.

The ECB had announced in January 2015 that it would undertake a full blown quantitative easing programme of purchases of Eurozone government and other bonds starting in March at €60bn per month. This put downward pressure on Eurozone bond yields. There was a further increase in this programme of QE in December 2015. The anti-austerity government in Greece, elected in January 2015 eventually agreed to implement an acceptable programme of cuts to meet EU demands after causing major fears of a breakup of the Eurozone. Nevertheless, there are continuing concerns that a Greek exit has only been delayed.

As for America, the economy has continued to grow healthily on the back of resilient consumer demand. The first increase in the central rate occurred in December 2015 since when there has been a return to caution as to the speed of further increases due to concerns around the risks to world growth.

On the international scene, concerns have increased about the slowing of the Chinese economy and also its potential vulnerability to both the bursting of a property bubble and major exposure of its banking system to bad debts. The Japanese economy has also suffered disappointing growth in this financial year despite a huge programme of quantitative easing, while two of the major emerging market economies, Russia and Brazil, are in recession. The situations in Ukraine, and in the Middle East with ISIS, have also contributed to volatility.

The UK elected a majority Conservative Government in May 2015, removing one potential concern but introducing another due to the promise of a referendum on the UK remaining part of the EU. The government maintained its tight fiscal policy stance but the more recent downturn in expectations for economic growth has made it more difficult to return the public sector net borrowing to a balanced annual position within the period of this parliament.

Credit Implications of the Brexit Vote

This note was provided by our Treasury Advisors, Capita Treasury Solutions, on the current implications of the Brexit Vote:

The following note provides an update on recent rating action taken on the UK sovereign rating. It also provides the latest position with regards to the implications for rated UK banks and Building Societies (banks collectively).

Sovereign Rating Action

As regards to the sovereign rating, the following has taken place since the Brexit vote was announced:

- Fitch

  Sovereign rating downgraded by one notch, from AA+ to AA.
  Outlook lowered to Negative, from Stable.
- Moody's

  Sovereign rating affirmed, at Aa1 (equivalent to AA+ from Fitch / S&P).

Outlook lowered to Negative, from Stable.

- Standard & Poor's (S&P)

Sovereign rating downgraded by two notches, from AAA to AA.
Remains on Negative Outlook.

We would suggest clients' review their Investment Strategy documents to see if these changes alone have any impact on investment limits. Where sovereign criteria is in place, we would suggest that this excludes the UK.

Bank Rating Action

At the time of writing, none of the three major rating agencies have taken any action in relation to UK entity ratings. As previously stated, part of the evolution of financial market regulations has seen the link between sovereigns and their respective banks materially weakened. Part of this was to break the "negative feedback loop" that has been evidenced in Europe, where concerns over banks have weighed on sovereigns, which then exacerbates the negative sentiment towards the banks…and then the process starts all over again. The result of the breakage of the link has meant that there is little or no "sovereign uplift" to any major bank ratings in the UK and beyond. Therefore, rating action at the sovereign level does not automatically mean that bank ratings will be similarly affected, certainly not in the case of the UK and its financial institutions.
However, as we have previously stated, the reasons for the change to a sovereign rating can equally impact on bank ratings. In this case, one of the key themes running through the rationale for recent action on the UK sovereign rating is the expected negative implications for the UK economic outlook. This, in turn, if they prove correct, could have an impact on the ratings of banks which focus the bulk of their business in the UK.
We have outlined below the latest position from each of the major rating agencies in relation to UK banks' ratings.

Fitch

In an article on the wider implications for credit from Brexit, the agency included the following section on banks:

"Banks Resilient to Moderately Weaker Operating Environment The impact of the "Leave" vote is broadly negative for the UK's banking sector. But there are no immediate rating implications for Fitch's bank IDRs because they are resilient to a moderate deterioration in the operating environment at their current rating level. The UK sovereign rating is currently not a constraining factor for any UK bank ratings. Future bank rating actions will depend on the evolution of macro factors, and the extent, duration and form of financial market volatility. The UK banks further strengthened liquidity ahead of the EU referendum and are therefore well placed to withstand market volatility that could limit their access to institutional funding. Central bank funding provides a further line of defence in case of more protracted market closure. Banks are likely to have taken steps to hedge any structural foreign exchange positions and to position trading books defensively. However, ratings could be downgraded should this not prove to be the case. Materially adverse developments following the referendum would affect UK bank ratings. The domestic focus of most UK banks means negative rating actions would most likely be triggered by a severe and structural deterioration of the UK operating environment. This could occur if unemployment rises significantly or house prices drop sharply, possibly exacerbated by net emigration or a steep interest rate rise, resulting in weaker asset quality. UK banks will face greater obstacles to generating good operating profitability after the "Leave" vote because loan growth is likely to remain subdued and interest rates could stay lower for longer. We expect increased foreign exchange (FX) and bond market volatility linked to news flow. But a sustainable increase in client trading volume and earnings is unlikely for banks with material markets businesses while clients face uncertainty. Long bouts of spikes in market volatility, reduced corporate issuance and lower M&A activity would also put pressure on profitability at global banking groups. We expect the impact to be limited to additional pressure on earnings, but lower revenue could result in banks reviewing business models that depend on generating a large part of earnings from UK capital markets. Any outcome that prevents banks located in the UK from undertaking business in EU countries would be moderately disruptive and costly to the large global banking groups, but we expect them to be able to operate through other EU legal entities." This would suggest that, in the near term, the agency does not expect to alter ratings as a result of the changes that have affected its view on the sovereign rating.

Moody's

As highlighted above, this agency has undertaken the least action on the sovereign rating so far. In terms of banks, there has been, at the time of writing, no official comment from the agency. However, there was a suggestion that it may follow up the change in the sovereign Outlook with similar action on bank Outlooks. At the present time these are mainly Stable, and in some cases Positive. However, the suggestions are that it would not move further than this…ie put in place Negative Watches… due to the uncertainty as to exit negotiations and the implications thereof at this stage.

Standard & Poor's

As we highlighted in our previous note on credit implications, the S&P process for rating financial entities all starts with the Banking Industry Country Risk Assessment (BICRA). This sets the "anchor" point for ratings, and is based on economic and industry factors. This "anchor" is then adjusted by the individual circumstances of the bank in question to formulate the final ratings for a financial institution. Last July, S&P made some slight positive adjustment to the UK BICRA, in light of a more favourable economic environment, but still kept the UK in Group 3…alongside Austria, Chile, Denmark, France, Korea, Netherlands and the US. Note that Groups run from 1 (lowest risk) to 10 (highest risk). This provides UK operating entities with an "anchor" rating point of bbb+.
In light of the reassessment of the sovereign rating as a result of Brexit, there is a risk that the agency could raise the economic and possibly the industry risk elements of the UK BICRA. If either of these risk elements is raised then the likelihood is that it would lower the anchor point for all UK operating financial institutions. In terms of timing, the agency typically releases BICRA rating updates each month, usually in the middle of the month. As such, we could potentially see a move on UK bank ratings in mid-July. We would hope that in the intervening time, the agency would make an adjustment to the Outlook / Watches of any banks that could be affected by such a change. This would be in keeping with the rating process flow we outlined in our previous note. However, at this juncture, there is little coming from the rating agency on which we can base our view. We will continue to have an active dialogue with the agency to gain a clearer understanding of their view and what implications it may have.

Summary

At the time of writing, none of the three major rating agencies has given a clear indication of any near-term action with regards to financial institution credit ratings. Of the three agencies, it would seem that S&P could be the most likely to make a further change in the near term, if they raise the risk profile of the UK in light of the Brexit vote. However, given the uncertainty surrounding the implications of Brexit it is by no means a certainty that they will act in the near term. We will keep clients updated via regular communications on any material updates. Further, our Passport system has live feeds to all three of the rating agencies, so any changes to ratings will be notified to you as they are processed. We would also stress that while there are negative implications for the UK, its economy and financial institutions as a result of Brexit, financial markets and the operators therein are materially stronger, in terms of capital and liquidity than they were ahead of the financial crisis. Mark Carney, Governor of the Bank of England stated on Friday, in the immediate aftermath of the vote that "…the capital requirements of our largest banks are now ten times higher than before the crisis. The Bank of England has stress tested them against scenarios more severe than the country currently faces. As a result of these actions, UK banks have raised over £130bn of capital, and now have more than £600bn of high quality liquid assets."