REPORT REFERENCE NO.	**DSFRA/17/15**
MEETING	**DEVON & SOMERSET FIRE & RESCUE AUTHORITY (Ordinary Meeting)**
DATE OF MEETING	**12 JUNE 2017**
SUBJECT OF REPORT	**ANNUAL TREASURY MANAGEMENT REPORT 2016-17**
LEAD OFFICER	**Treasurer**
RECOMMENDATIONS	***That the performance in relation to the treasury management activities of the Authority for 2016-17, as set out in this report, be noted.***
EXECUTIVE SUMMARY	The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management, requires that the Authority receives a report in respect of borrowing and investment activities during the year, and compares this performance against the treasury management strategy adopted. The report includes a performance report relating to the 2016-17 financial year. A representative (Adam Burleton) from Capita Asset Services, the Authority external treasury management advisors, will be in attendance at the meeting to present the performance report.
RESOURCE IMPLICATIONS	As indicated within the report.
EQUALITY RISK AND BENEFIT ASSESSMENT (ERBA)	An initial assessment has not identified any equality issues emanating from this report.
APPENDICES	A. Prudential indicators 2016-17.
LIST OF BACKGROUND PAPERS	Treasury Management Strategy (including Prudential and Treasury Indicators) Report to budget meeting held on the 19th February 2016 DSFRA/16/3

1. INTRODUCTION

1.1 The Authority is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2016-17. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

1.2 The Authority fully complies with the primary requirements of the Code, which includes:

- The creation and maintenance of a Treasury Management Policy Statement, which sets out the policies and objectives of the Authority's treasury management activities.
- The creation and maintenance of Treasury Management Practices, which set out the manner in which the Authority will seek to achieve those policies and objectives.
- The receipt by the Authority of an annual strategy report for the year ahead, a mid-year treasury update report and an annual review report of the previous year.
- The delegation by the Authority of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
- Delegation by the Authority of the role of scrutiny of treasury management strategy and policies to a specific named body which in this Authority is the Resources Committee.

1.3 During 2016-17 the minimum reporting requirements were that the full Authority should receive the following reports:

- an annual treasury strategy in advance of the year (Authority meeting (9th February 2016).
- a mid-year (minimum) treasury update report (Authority meeting 19th December 2016).
- an annual review following the end of the year describing the activity compared to the strategy (this report).

1.4 In addition, the Resources Committee has received quarterly treasury management update reports on 1st September 2016, 02/09/2015, 16th November 2016 and 8th February 2017.

1.5 The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is therefore important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Authority's policies previously approved by members.

1.6 The Treasury Management Strategy for the Authority has been underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) 2011 Treasury Management in Public Services Code of Practice (the Code) and the CIPFA Prudential Code.

1.7 Treasury management in this context is defined as:

"The management of the local Authority's investments and 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. "

2. THE ECONOMY AND INTEREST RATES

2.1 The two major landmark events that had a significant influence on financial markets in the 2016-17 financial year were the UK EU referendum on 23 June and the election of President Trump in the USA on 9 November. The first event 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.

2.2 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.

2.3 In the second half of 2016, the UK economy confounded the Bank's pessimistic forecasts of August. After a disappointing quarter 1 of only +0.2% GDP growth, the three subsequent quarters of 2016 came in at +0.6%, +0.5% and +0.7% to produce an annual growth for 2016 overall, compared to 2015, of no less than 1.8%, which was very nearly the fastest rate of growth of any of the G7 countries. Needless to say, this meant that the MPC did not cut Bank Rate again after August but, since then, inflation has risen rapidly due to the effects of the sharp devaluation of sterling after the referendum.

2.4 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 look through near term supply side driven inflation, (i.e. not raise Bank Rate), caused by sterling's devaluation, 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.

2.5 **USA**. Quarterly growth in the US has been very volatile during 2016 but 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 interest rates. Overall growth in 2016 was 1.6%.

2.6 **EU**. The EU is furthest away from an increase in short term interest 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.

2.7 **Japan** struggled to stimulate consistent significant growth with GDP averaging only 1.0% in 2016 with current indications pointing to a similar figure for 2017. It is also struggling to get inflation up to its target of 2%, only achieving an average of -0.1% in 2016, despite huge monetary and fiscal stimulus, though this is currently expected to increase to around 1% in 2017. It is also making little progress on fundamental reform of the economy.

2.8 **China** and emerging market counties. At the start of 2016, there were considerable fears that China's economic growth could be heading towards a hard landing, which could then destabilise some emerging market countries particularly exposed to a Chinese economic slowdown and / or to the effects of a major reduction in revenue from low oil prices. These fears have largely subsided and oil prices have partially recovered so, overall, world growth prospects have improved during the year.

2.9 **Gilt Markets** – The bond purchases undertaken by the ECB as part of the quantitative easing programme have resulted in depressed bond yields in the EU, but, towards the end of 2016, yields rose, probably due at least in part to rising political concerns around the positive prospects for populist parties and impending general elections in 2017 in the Netherlands, France and Germany. On the other hand, President Trump's election and promise of fiscal stimulus, which are likely to increase growth and inflationary pressures in the US, have resulted in Treasury yields rising sharply since his election. Gilt yields in the UK have been caught between these two influences and the result is that the gap in yield between US treasuries and UK gilts has widened sharply during 2016/17 due to market perceptions that the UK is still likely to be two years behind the US in starting on an upswing in rates despite a track record of four years of strong growth. UK gilt yields are used to price the borrowing rates available from the Public Works Loans Board, so are important when any new external loans are being considered.

2.10 **Equity markets**. The result of the referendum, and the consequent devaluation of sterling, boosted the shares of many FTSE 100 companies which had major earnings which were not denominated in sterling. The overall trend since then has been steeply upwards and received further momentum after Donald Trump was elected President as he had promised a major fiscal stimulus to boost the US economy and growth rate.

3. OVERALL TREASURY POSITION AS AT 31 MARCH 2017

3.1 The Council's debt and investment position is organised by the treasury management service in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through member reporting detailed in the summary, and through officer activity detailed in the Authority's Treasury Management Practices.

3.2 At the end of 2016-17 the Authority's treasury, position was as shown overleaf:

SUMMARY	31st March 2016 Principal	Rate/ Return	31st March 2017 Principal	Rate/ Return
Total Debt - PWLB (All fixed rate funding)	*£25.817m*	*4.231%*	*£25.723m*	*4.233%*
-Other Long Term Liabilities	*£1.444m*		*£1.374m*	
Total	*£27.261m*		*£27.097m*	
CFR	*£27.262m*		*£27.098m*	
Over/(under) borrowing	*(0.001)m*		*(£0.001)m*	
Total Investments	*£27.325m*	*0.56%*	*£34.662m*	*0.51%*
NET DEBT	***£(0.064)m***		***£(7.565)m***	

3.3 The maturity structure of the debt portfolio was as follows:

	31 March 2016 actual	2016/17 original limits	31 March 2017 actual
Under 12 months	£0.094m	£0.094m	£0.094m
12 months and within 24 months	£0.094m	£0.094m	£0.094m
24 months and within 5 years	£0.780m	£0.780m	£0.780m
5 years and within 10 years	£1.631m	£4.131m	£4.131m
Over 10 years	£23.219m	£20.625m	£20.625m

4. STRATEGY FOR 2016-17

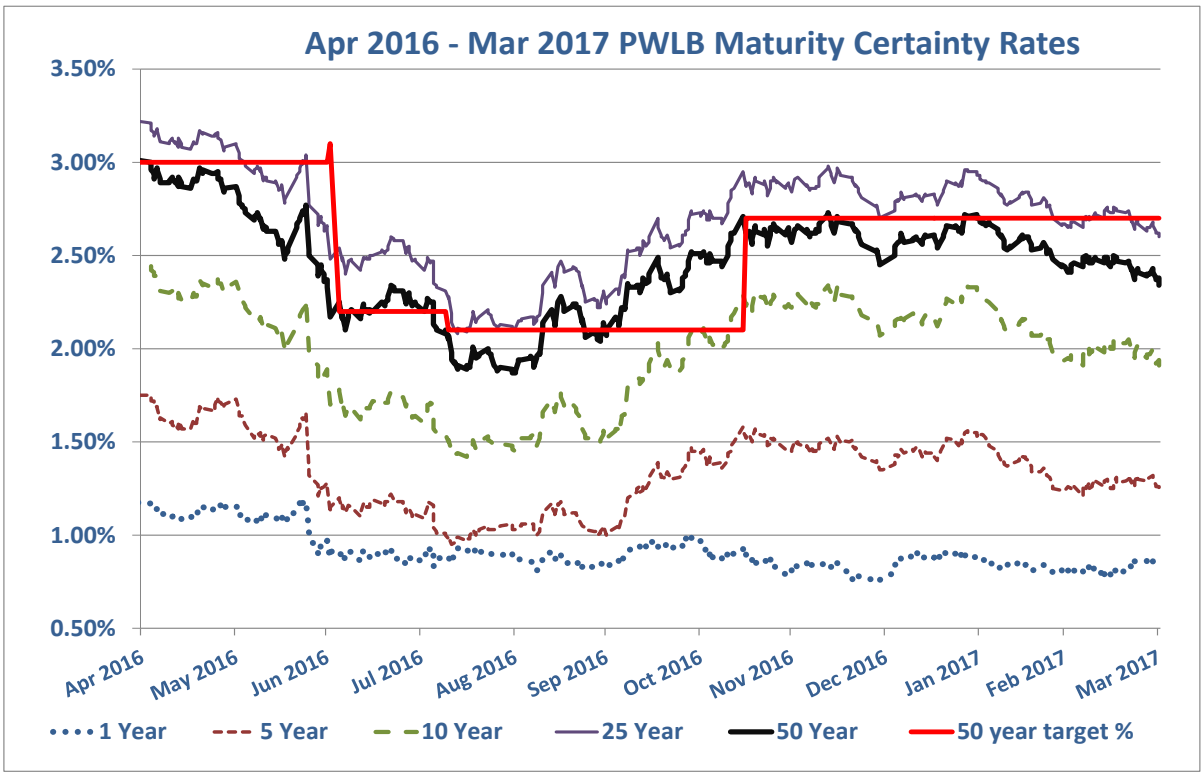
4.1 The expectation for interest rates within the strategy for 2016-17 anticipated low but rising Bank Rate (starting in quarter 1 of 2017), and gradual rises in medium and longer term fixed borrowing rates during 2016-17. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period. Continued uncertainty in the aftermath of the 2008 financial crisis promoted a cautious approach, whereby investments would continue to be dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

4.2 In this scenario the strategy was to postpone new borrowing and bring the level of external loans in line with the Capital Financing Requirement as at 31st March 2016.If short term interest rates remain low, the Authority will borrow internally to avoid the cost of holding higher levels of investment and to reduce counterparty risk.

5. BORROWING

Public Works Loan Board (PWLB) borrowing rates 2016-17

5.1 During 2016-17, PWLB rates fell from April to June and then gaining fresh downward impetus after the referendum and Bank Rate cut, before staging a partial recovery through to December and then falling slightly through to the end of March. The graph and table below, show, for a selection of maturity periods, the average borrowing rates, the high and low points in rates, spreads and individual rates at the start and the end of the financial year.



	1 Year	5 Year	10 Year	25 Year	50 Year
1/4/16	1.13%	1.62%	2.31%	3.14%	2.95%
31/3/17	0.83%	1.24%	1.60%	1.80%	2.07%
Low	0.76%	0.95%	1.42%	2.08%	1.87%
Date	20/12/2016	10/08/2016	10/08/2016	12/08/2016	30/08/2016
High	1.20%	1.80%	2.51%	3.28%	3.08%
Date	27/04/2016	27/04/2016	27/04/2016	27/04/2016	27/04/2016
Average	0.93%	1.36%	2.01%	2.72%	2.49%

DSFRA Borrowing Strategy

Prudential Indicators

5.2 It is a statutory duty for the Authority to determine and keep under review the "Affordable Borrowing Limits". The Authority's' approved Prudential Indicators (affordability limits) are outlined in the approved Treasury Management Strategy.

5.3 During the financial year the Authority operated within the treasury limits and Prudential Indicators set out in its annual Treasury Strategy Statement. The outturn for the Prudential Indicators is shown in Appendix A.

Authority borrowing during and at the end of 2016-2017

5.4 No new borrowing was taken out in 2016-17 to support capital spending and therefore, because repayments of £0.0.094m loan principal have been made in year, the value of loans outstanding has decreased to £25.723m during the year. A summary of the loan (debt) position of the Authority is given in the table below. All existing borrowing has been taken out at Fixed Interest Rates.

5.5 It is noted that the external borrowing figure of £25.723m as 31 March 2017 is within the Capital Financing Requirement (CFR) which means that there is no over-borrowing position at the year-end.

5.6 No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

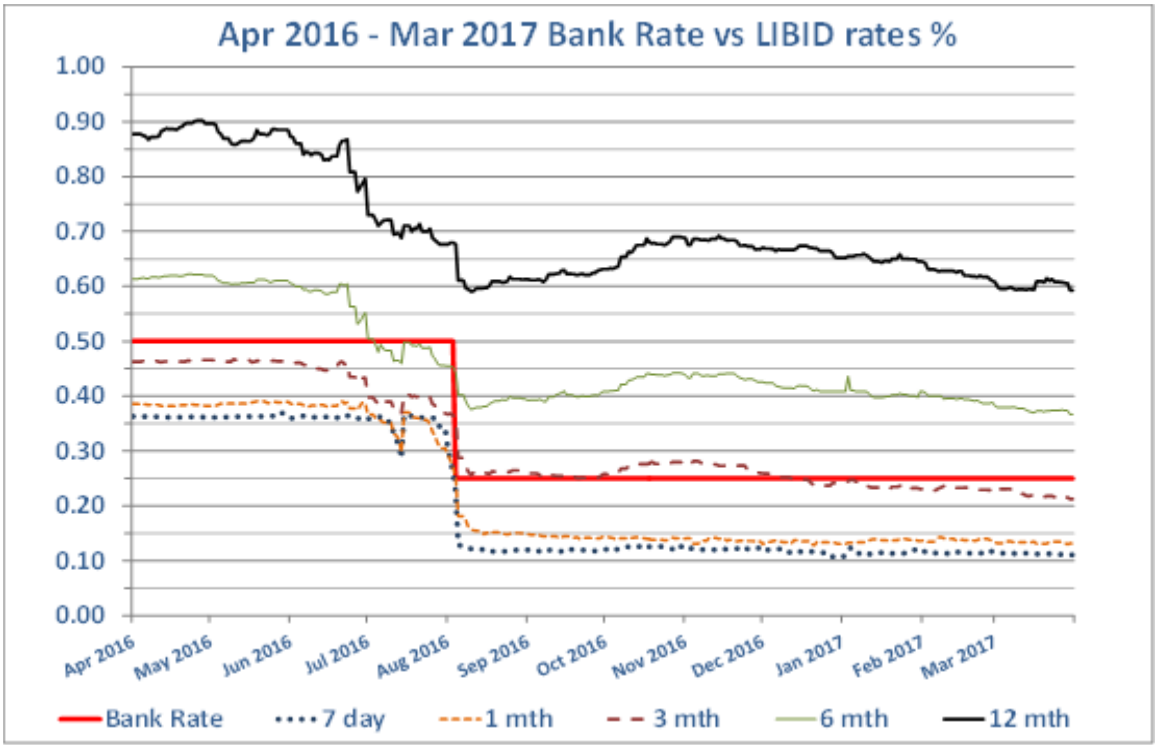
	Summary of loan movements during 2016-17		
		Amount £m	
	Value of loans outstanding as at 1/4/2016	**25.817**	
	Loans taken during 2016-17	0.00	
	Loans repaid upon maturity during year	(0.094)	
	Loans rescheduled during year	0.00	
	Total value of loans outstanding as at 31/3/2017	**25.723**	

6. INVESTMENTS

Investment rates in 2016-17

6.1. After the EU referendum, the Monetary Policy Committee (MPC) cut the Bank Rate from 0.5% to 0.25% at their meeting on 4 August. It remained at that level for the rest of the financial year. Market expectations as to the timing of the start of monetary tightening (Bank Rate increases) started the year at quarter 3 2018, but then moved back to around the end of 2019 in early August before finishing the financial year back at quarter 3 2018.

6.2. At the start of 2016-17 the deposit rates available in the money markets continued at the previous depressed levels. These rates fell during the first two quarters and reduced even further after the 4 August MPC meeting when an additional large tranche of cheap financing was made available to the banking sector by the Bank of England. The deposit rates made a weak recovery towards the end of 2016 but then fell to fresh lows in March 2017.



Authority Investment Strategy

6.3. 6.3 The Authority's Annual Investment Strategy, which is incorporated in the Treasury Management Strategy Statement, outlines the Authority's investment priorities as follows:

- Security of Capital
- Liquidity

6.4. The Authority will also aim to achieve the optimum return on investments commensurate with the proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term, and only invest with highly credit rated financial institutions using our Treasury Management Advisors (Capita) suggested creditworthiness matrices, including Credit Default Swap overlay information provided by Sector. In addition to this approach the Authority has the ability to use building societies under specified and non-specified investments.

Authority Investments during and at the end of 2016-17

6.5. No institutions in which investments were made during 2016-17 had any difficulty in repaying investments and interest in full during the year and the Authority had no liquidity difficulties.

6.6. A full list of investments held as at 31 March 2017 are shown in the table below:

Investments as at 31 March 2017					
Counterparty	**Maximum to be invested**	**Total amount invested**	**Call or Term**	**Period invested**	**Interest rate(s)**
	£m	**£m**			
Bank of Scotland	5.000	2.100	T	6 mths	0.600%
		1.500	T	6 mths	0.650%
		1.400	T	6 mths	0.650%
Goldman Sachs	5.000	5.000	T	6 mths	0.680%
Leeds Building Society	2.000	1.000	T	6 mths	0.430%
Santander UK PLC	5.000	1.000	T	6 mths	0.510%
		2.000	T	6 mths	0.420%
Sumitomo Mitsui	5.000	3.200	T	6 mths	0.430%
		1.800	T	6 mths	0.460%
Coventry Building Society	2.000	2.000	T	6 mths	0.370%
Nationwide Building Society	2.000	2.000	T	6 mths	0.370%
Black Rock Money Market Fund	5.000	0.532	C	Instant Access	Variable
Ignis Sterling Liquidity Money Market Fund	5.000	1.800	C	Instant Access	Variable
Federated	5.000	0.330	C	Instant Access	Variable
Qatar National Bank	5.000	1.000	T	1 yr	0.820%
		1.000	T	1 Yr	0.750%
		3.000	T	1 Yr	0.820%
Local Authority	5.000	4.000	T	63 Days	0.450%
Total invested as at 31 March 2017		**£34.662M**			

6.7. Funds available for investment are on a temporary basis, the level of which are dependent on the timing of precept payments, receipt of grants and progress on the Capital Programme.

Benchmark	**Average level of funds available for Investment**	**Benchmark Return**	**Authority Performance**	Investment Interest Earned
3 month	£35.552m	0.31%	0.51%	£0.205m

6.8. The amount of investment income earned of £0.205m has exceeded the target by £0.052m as a result of levels of fund available for investment during the year being higher than anticipated.

7. SUMMARY

7.1 In compliance with the requirements of the CIPFA Code of Practice of Treasury Management, this report provides Members with a summary report of the treasury management activities during 2016-17. As is indicated in this report, none of the Prudential Indicators have been breached, and a prudent approach has been taken in relation to investment decisions taken during the year, with priority being given to liquidity and security over yield.

7.2 Continued uncertainty in the aftermath of the 2008 financial crisis promoted a cautious approach, whereby investments continued to be dominated by risk considerations resulting in relatively low returns compared to borrowing rates. Even so, the Authority is able to report that its returns are above the London Inter-Bank Bid Rate 3 month rate, the benchmark return for this type of short term investments.

KEVIN WOODWARD
Treasurer

APPENDIX A TO REPORT DSFRA/17/15

PRUDENTIAL INDICATOR	2015-16 £m actual	2016-17 £m approved	2016-17 £m Actual
Capital Expenditure			
Non – HRA	6.171	6.423	2.758
HRA (applies only to housing authorities)	0	0	0
TOTAL	6.171	6.423	2.758
Ratio of financing costs to net revenue stream			
Non – HRA	3.64%	4.18%	4.11%
HRA (applies only to housing authorities)	0%	0%	0%
Capital Financing Requirement as at 31 March (borrowing only)			
Non – HRA	25.817	25.724	25.723
HRA (applies only to housing authorities)	0	0	0
TOTAL	25.817	25.724	25.723
Annual change in Cap. Financing Requirement			
Non – HRA	3.235	(0.163)	(0.094)
HRA (applies only to housing authorities)	0	0	0
TOTAL	3.235	(0.163)	(0.094)
Incremental impact of capital investment decisions	**£ p**	**£ p**	**£ p**
Increase/(decrease) in council tax (Band D) per annum	(£0.10)	£0.04	£0.04
TREASURY MANAGEMENT PRUDENTIAL INDICATORS			
	£m	**£m**	**£m**
Authorised Limit for external debt -			
Borrowing	29.477	26.824	26.824
other long term liabilities	1.516	1.278	1.278
TOTAL	30.993	28.102	28.102
Operational Boundary for external debt -			
Borrowing	28.186	25.537	25.537
other long term liabilities	1.444	1.209	1.209
TOTAL	29.630	26.746	26.746

	Actual 31st March 2017	upper limit %	lower limit %
Limits on borrowing at fixed interest rates	100%	100%	70%
Limits on borrowing at variable interest rates	0%	30%	0%
Maturity structure of fixed rate borrowing during 2016-17			
Under 12 months	0.36%	30%	0%
12 months and within 24 months	0.36%	30%	0%
24 months and within 5 years	3.03%	50%	0%
5 years and within 10 years	16.06%	75%	0%
10 years and above	80.18%	100%	50%