**Cabinet**
**14 May 2018**

# Annual Treasury Management Review 2017/18

**Cabinet Member:** Councillor Peter Hare-Scott
**Responsible Officer:** Director of Finance, Assets & Resources, Andrew Jarrett

**Reason for Report:** To provide Members with a review of activities and the actual prudential treasury indicators for 2017/18.

**Recommendations(s):**
**That Members note the treasury activities for the year.**

**Relationship to the Corporate Plan**: Maximising our return from all associated treasury activities enables the Council to support current levels of spending in accordance with our Corporate Plan.

**Financial Implications:** Good financial management and administration underpins the entire strategy.

**Legal Implications:** Authorities are required by regulation to have regard to the Prudential Code when carrying out their duties under Part 1 of the Local Government Act 2003.

**Risk Assessment:** The S151 Officer is responsible for the administration of the financial affairs of the Council. Implementing this strategy and the CIPFA Code of Practice on Treasury Management manages the risk associated with the Council's treasury management activity.

## 1. Introduction

1.1 The Council 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 2017/18. 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 During 2017/18 the minimum reporting requirements were that the Council should receive the following reports:

- an annual treasury strategy in advance of the year (Cabinet 02/03/2017)
- a mid-year treasury update report (Cabinet 23/11/2017)

- an annual review following the end of the year describing the activity compared to the strategy (this report)

1.3 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 Council's policies previously approved by Members.

## 2. The Economy and Interest Rates

2.1 During the calendar year of 2017, there was a major shift in expectations in financial markets in terms of how soon Bank Rate would start on a rising trend. After the UK economy surprised on the upside with strong growth in the second half of 2016, growth in 2017 was disappointingly weak in the first half of the year, which meant that growth was the slowest for the first half of any year since 2012. The main reason for this was the sharp increase in inflation caused by the devaluation of sterling after the EU referendum, feeding increases into the cost of imports into the economy. This caused a reduction in consumer disposable income and spending power as inflation exceeded average wage increases. Consequently, the services sector of the economy, accounting for around 75% of GDP, saw weak growth as consumers responded by cutting back on their expenditure. However, growth did pick up modestly in the second half of 2017. Consequently, market expectations during the autumn rose significantly that the MPC would be heading in the direction of imminently raising Bank Rate. The minutes of the MPC meeting of 14 September indicated that the MPC was likely to raise Bank Rate very soon. The 2 November MPC quarterly Inflation Report meeting duly delivered by raising Bank Rate from 0.25% to 0.50%.

2.2 The 8 February MPC meeting minutes then revealed another sharp hardening in MPC warnings on a more imminent and faster pace of increases in Bank Rate than had previously been expected.

2.3 Market expectations for increases in Bank Rate, therefore, shifted considerably during the second half of 2017-18 and resulted in **investment rates** from 3 – 12 months increasing sharply during the spring quarter.

2.4 **PWLB borrowing rates** increased correspondingly to the above developments with the shorter term rates increasing more sharply than longer term rates. In addition, UK gilts have moved in a relatively narrow band this year, (within 25 bps for much of the year), compared to **US treasuries**. During the second half of the year, there was a noticeable trend in treasury yields being on a rising trend with the Fed raising rates by 0.25% in June, December and March, making six increases in all from the floor. The effect of these three increases was greater in shorter terms around 5 years, rather than longer term yields.

2.5 The major UK landmark event of the year was the inconclusive result of the **general election** on 8 June. However, this had relatively little impact on financial markets.

## 3. Overall Treasury Position as at 31 March 2018

3.1 At the beginning and the end of 2017/18 the Council's treasury, (excluding borrowing by PFI and finance leases), position was as follows:

| TABLE 1 | 31 March 2017 Principal | 31 March 2018 Principal |
|---|---|---|
| **Total external debt** | ***£43.9m*** | ***£42.4m*** |
| **CFR** | ***£50.6m*** | ***£49.4m*** |
| **Over / (under) borrowing** | ***(£6.7m)*** | ***(£7m)*** |
| **Total investments** | ***£23m*** | ***£26m*** |
| **Net debt** | **£20.9m** | **£16.4m** |

## 4. The Strategy for 2017/18

4.1 The expectation for interest rates within the treasury management strategy for 2017/18 anticipated that Bank Rate would not start rising from 0.25%[until quarter 2, 2019 and then only increase once more before 31 March 2020. There would also be gradual rises in medium and longer term fixed borrowing rates during 2017/18 and the two subsequent financial years. 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 treasury strategy was to postpone borrowing to avoid the cost of holding higher levels of investments and to reduce counterparty risk.

4.3 During 2017/18, longer term PWLB rates were volatile but with little overall direction, whereas shorter term PWLB rates were on a rising trend during the second half of the year.

## 5. The Borrowing Requirement and Debt

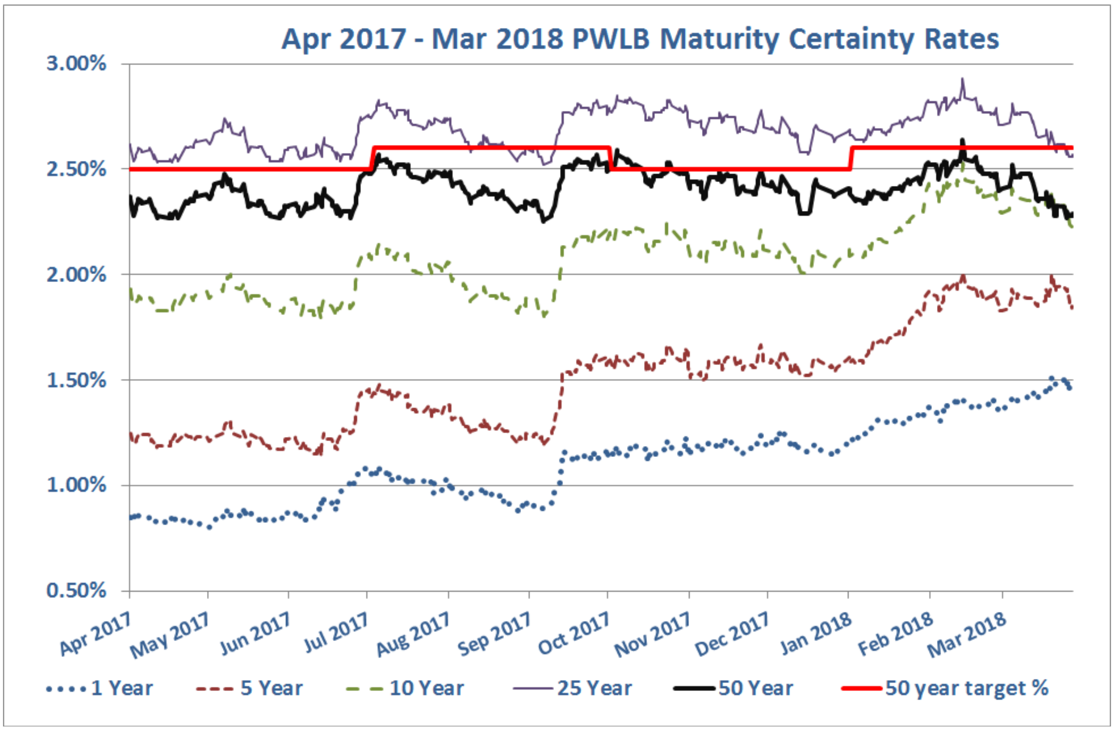
5.1 The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).

|  | 31 March 2017 Actual | 31 March 2018 Actual |
|---|---|---|
| CFR General Fund (£m) | 6.5 | 6.3 |
| CFR  HRA (£m) | 44.1 | 43.1 |
| Total CFR | 50.6 | 49.4 |

## 6. Borrowing Rates in 2017/18

**6.1** **PWLB certainty maturity borrowing rates.** As depicted in the graph and tables below 25 and 50 year rates have been volatile during the year with little consistent trend. However, shorter rates were on a rising trend during the second half of the year and reached peaks in February / March.

6.2 During the year, the 50 year PWLB target (certainty) rate for new long term borrowing was 2.50% in quarters 1 and 3 and 2.60% in quarters 2 and 4. The graphs and tables for PWLB rates 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.



## 7. Borrowing Outturn for 2017/18

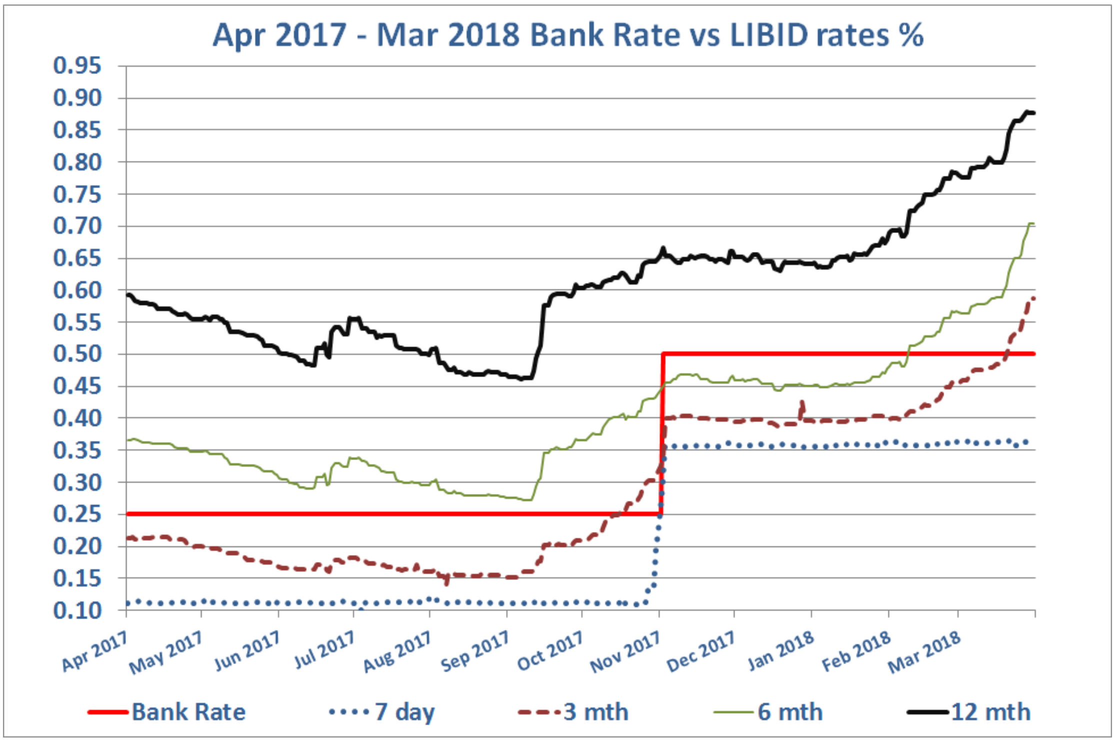
7.1 **Borrowing** – the following loans were taken during the year:-

| Lender | Principal | Type | Interest Rate | Maturity |
|---|---|---|---|---|
| PWLB | 0.207M | Annuity | 1.70% | 5 |

7.2 **Rescheduling -** no rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

## 8. Investment Rates in 2017/18

8.1 Investments rates for 3 months and longer have been on a rising trend during the second half of the year in the expectation of Bank Rate increasing from its floor of 0.25%, and reached a peak at the end of March. Bank Rate was duly raised from 0.25% to 0.50% on 2 January 2017 and remained at that level for the rest of the year. However, further increases are expected over the next few years. Deposit rates continued into the start of 2017/18 at previous depressed levels due, in part, to a large tranche of cheap financing being made available under the Term Funding Scheme to the banking sector by the Bank of England; this facility ended on 28 February /18.



**9. Investment Outturn for 2017/18**

9.1 **Investment Policy** – the Council's investment policy is governed by MHCLG guidance, which has been implemented in the annual investment strategy approved by the Cabinet on 2 March 2017. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data, (such as rating outlooks, credit default swaps).

9.2 The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

9.3 **Investments held by the Council** - the Council maintained an average balance of £19m of internally managed funds. The internally managed funds earned an average rate of return of 0.58%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.36%. The Council held £5m invested in CCLA property funds earning dividends of 4.47% in 17/18.

**10. Other Issues**

10.1 **Revised CIPFA Codes**

10.1.1 In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued a revised Treasury Management Code and Cross Sectoral Guidance Notes, and a revised Prudential Code.

10.1.2 A particular focus of these revised codes was how to deal with local authority investments which are not treasury type investments e.g. by investing in purchasing property in order to generate income for the Authority at a much higher level than can be attained by treasury investments. One recommendation was that local authorities should produce a new report to Members to give a high level summary of the overall capital strategy and to enable Members to see how the cash resources of the Authority have been apportioned between treasury and non-treasury investments. Officers will report to members when the implications of these new codes have been assessed as to the likely impact on this Authority.

10.2 **Markets in Financial Instruments Directive II (MiFID II)**

10.2.1 The EU set the date of 3 January 2018 for the introduction of regulations under MIFID II. These regulations govern the relationship that financial institutions conducting lending and borrowing transactions will have with local authorities from that date. This has had little effect on this Authority apart from having to fill in forms sent by each institution dealing with this Authority and for each type of investment instrument we use, apart from for cash deposits with banks and building societies.

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Background papers: Link Annual Treasury Management Review template

Circulation of the report: Councillor Peter Hare-Scott, Leadership Team, Group Manager for Finance

## Appendix 1: Prudential and Treasury Indicators

During 2017/18, the Council complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

| Actual prudential and treasury indicators | 2016/17 Actual £000 | 2017/18 Actual £000 |
|---|---|---|
| Capital expenditure | | |
| • General Fund | 816 | 4,234 |
| • HRA | 4,477 | 4,288 |
| • Total | 5,293 | 8,522 |
| | | |
| | | |
| Capital Financing Requirement: | | |
| • General Fund | 6,479 | 6,310 |
| • HRA | 44,144 | 43,166 |
| • Total | 50,623 | 49,476 |
| | | |
| Gross borrowing | 44,454 | 42,825 |
| | | |
| Investments | | |
| • Longer than 1 year | 5,000 | 5,000 |
| • Under 1 year | 18,000 | 21,000 |
| • Total | 23,000 | 26,000 |
| | | |
| Net borrowing | 21,454 | 16,825 |

**Gross borrowing and the CFR** - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2017/18) plus the estimates of any additional capital financing requirement for the current (2018/19) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs in 2017/18.

**The authorised limit** - the authorised limit is the “affordable borrowing limit” required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level. The table below demonstrates that during 2017/18 the Council has maintained gross borrowing within its authorised limit.

**The operational boundary** – the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary is acceptable subject to the authorised limit not being breached.

**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.

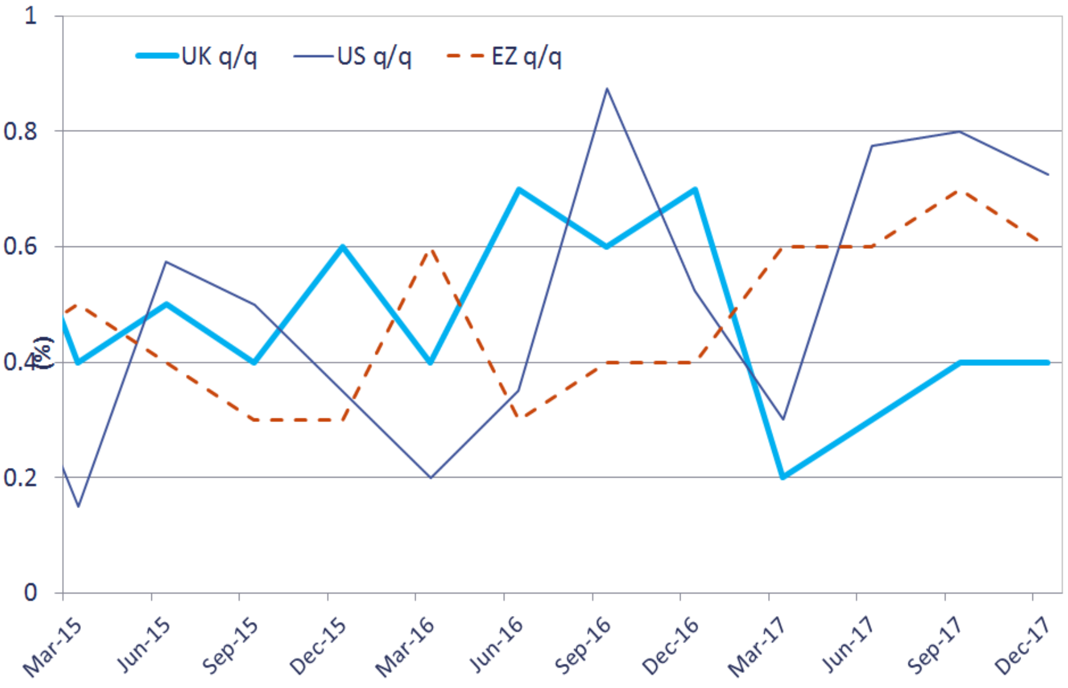
| | 2017/18 |
|---|---|
| Authorised limit | £55.0m |
| Maximum gross borrowing position | £43.7m |
| Operational boundary | £50.0m |
| Average gross borrowing position | £43.37m |
| Financing costs as a proportion of net revenue stream (GF) | 1.64% |
| Financing costs as a proportion of net revenue stream (HRA) | 16.82% |
| Interest paid on borrowing (GF) | £0.144m |
| Interest paid on borrowing (HRA) | £1.213m |
| Interest Receivable (incl dividends) (GF) | £0.344m |
| Interest Receivable (HRA) | £0.038m |

The maturity structure of the debt portfolio was as follows:

| | 31 March 2017 Actual(£m) | 31 March 2018 Actual(£m) |
|---|---|---|
| Under 12 months | 1.73 | 1.73 |
| 12 months and within 24 months | 1.69 | 1.78 |
| 24 months and within 5 years | 5.36 | 5.63 |
| 5 years and within 10 years | 9.92 | 10.19 |
| 10 years and within 20 years | 24.62 | 22.68 |
| Over 20 years | 0.66 | 0.44 |

## Appendix 2: Graphs

### UK, US and EZ GDP growth




### Inflation UK, US, Germany and France