COUNCIL

11 SEPTEMBER 2018

REPORT OF THE PORTFOLIO HOLDER FOR ASSETS AND FINANCE

ANNUAL REPORT ON THE TREASURY MANAGEMENT SERVICE AND ACTUAL PRUDENTIAL INDICATORS 2017/18

PURPOSE

The Annual Treasury report is a requirement of the Council's reporting procedures. It covers the Treasury activity for 2017/18, and the actual Prudential Indicators for 2017/18.

The report meets the requirements of both the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities. The Council is required to comply with both Codes in accordance with Regulations issued under the Local Government Act 2003. It also provides an opportunity to review the approved Treasury Management Strategy for the current year and enables Members to consider and approve any issues identified that require amendment.

RECOMMENDATIONS

That Council;

1. **Approve the actual 2017/18 Prudential and Treasury Indicators within the report and shown at Appendix 1; and**

2. **Accept the Annual Treasury Management Report for 2017/18.**

EXECUTIVE SUMMARY

This report covers Treasury operations for the year ended 31st March 2018 and summarises:

- the Council's Treasury position as at 31st March 2018; and
- Performance Measurement

The key points raised for 2017/18 are

1. The Council's Capital Expenditure and Financing 2017/18
2. The Council's Overall Borrowing Need
3. Treasury Position as at 31st March 2018
4. The Strategy for 2017/18
5. The Economy and Interest Rates
6. Borrowing Rates in 2017/18
7. Borrowing Outturn for 2017/18
8. Investment Rates in 2017/18

9. Investment Outturn for 2017/18
10. Performance Measurement
11. Other Issues

The Treasury Function has achieved the following favourable results:

- The Council has complied with the professional codes, statutes and guidance;
- There are no issues to report regarding non-compliance with the approved prudential indicators;
- The Council maintained an average investment balance externally invested of £61.3m and achieved an average return of 0.54% (budgeted at £50.3m and an average return of 0.50%).
- This result compares favourably with the Council's own Benchmarks of the average 7 day and the 3 month LIBID rates for 2017/18 of 0.22% and 0.29%;
- The closing weighted average internal rate on borrowing has reduced in year to 4.05% (4.26% for 2016/17);
- The Treasury Management Function has achieved an outturn investment income of £331k compared to a budget of £260k as a result of both investment balances and average interest rates being higher than budgeted.

During 2017/18 the Council complied with its legislative and regulatory requirements.

The Executive Director Finance confirms that there was no overall increase in borrowing within the year and the Authorised Limit was not breached. On two occasions during 2017/18 the approved counterparty limits within the Annual Investment Strategy were exceeded:

- The first occurred on 22nd December 2017 when early payments of business rates resulted in £1.696m being held within the Lloyds Bank account, which exceeded the approved limit of £1m by £696k for a period over the weekend and Christmas bank holiday.
- The second occurred on 2nd January 2018 when the repayment of a £2m investment resulted in £2.048m being held in the Lloyds Bank account, exceeding the approved limit by £1.048m overnight.

At 31st March 2018, the Council's external debt was £63.060m (£63.060m at 31st March 2017) and its external investments totalled £60.77m (£50.119m at 31st March 2017) – including interest credited but excluding impaired investments.

RESOURCE IMPLICATIONS

There are no financial implications or staffing implications arising directly from the report.

LEGAL/RISK IMPLICATIONS

The Council is aware of the risks of passive management of the Treasury Portfolio and with the support of Link Asset Services, the Council's current Treasury advisers, has proactively managed its debt and investments during the year.

SUSTAINABILITY IMPLICATIONS

None

REPORT AUTHOR

If Members would like further information or clarification prior to the meeting please contact Stefan Garner, telephone 01827 709242 or email stefan-garner@tamworth.gov.uk

LIST OF BACKGROUND PAPERS

- Local Government Act 2003;
- Statutory Instruments: 2003 No 3146 & 2007 No 573;
- CIPFA Code of Practice on Treasury Management in Public Services;
- Treasury Management Strategy 2017/18 (Council 21st February 2017);
- Treasury Management Mid-Year Review 2017/18 (Council 12th December 2017);
- Treasury Outturn Report 2016/17 (Council 12th September 2017);
- CIPFA Treasury Benchmarking Club Report 2017;
- Treasury Management Strategy 2018/19 (Council 27th February 2018).

APPENDICES

Appendix 1 – Prudential and Treasury Indicators

Appendix 2 – Borrowing and Investment Rates

This 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).

During 2017/18 the minimum reporting requirements were complied with:

- an annual treasury strategy in advance of the year (Council 21st February 2017)
- a mid-year (minimum) treasury update report (Council 12th December 2017)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

In addition, Cabinet has received quarterly Treasury management updates as part of the Financial Healthcheck Reports.

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.

This Council also confirms that it has complied with the requirement under the Code to provide scrutiny of all of the above Treasury Management Reports to the Audit and Governance Committee. Member training on Treasury Management issues was provided in February 2018, and will also be provided as and when required in order to support members' scrutiny role.

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.

Prudential & Treasury Indicators	2016/17 Actual £m	2017/18 Estimate £m	2017/18 Actual £m
Capital Expenditure			
Non HRA	1.408	2.421	**1.545**
HRA	7.351	16.413	**7.655**
Total	8.759	18.834	**9.200**
Capital Financing Requirement			
Non HRA	0.943	1.885	**0.885**
HRA	68.041	75.255	**68.041**
Total	68.984	77.140	**68.926**
Gross Borrowing			
External Debt	63.060	65.060	**63.060**
Investments			
Longer than 1 year	-	-	**-**
Less than 1 year	51.211	58.143	**60.805**
Total	51.211	58.143	**60.805**
Net Borrowing	11.849	6.917	**2.255**

It should be noted that **£27.304m** of scheme spend has been re-profiled into 2018/19 (also including re-profiling from previous years) which has increased investment balances.

The Executive Director Finance confirms that there was no overall increase in borrowing in year and the statutory borrowing limit (the authorised limit) was not breached.

The financial year 2017/18 continued the challenging investment environment of previous years, namely low investment returns.

1. The Council's Capital Expenditure and Financing 2017/18

The Council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or
- If insufficient financing is available, or a decision is taken not to apply internal funds, the capital expenditure would give rise to a borrowing need.

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

General Fund	2016/17 Actual £m	2017/18 Estimate £m	2017/18 Actual £m
Capital Expenditure	1.408	2.421	**1.545**
Financed in year	1.408	2.421	**1.545**
Unfinanced capital expenditure	-	-	**-**
HRA	**2016/17 Actual £m**	**2017/18 Estimate £m**	**2017/18 Actual £m**
Capital Expenditure	7.351	16.413	**7.655**
Financed in year	7.351	11.441	**7.655**
Unfinanced capital expenditure	-	4.972	**-**

2. The Council's Overall Borrowing Need

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 indebtedness. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represents the 2017/18 unfinanced capital expenditure (see above table), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the Government, through the Public Works Loan Board [PWLB] or the money markets), or utilising temporary cash resources within the Council.

Reducing the CFR – the Council's (non HRA) underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision (MRP), to reduce the CFR. This is effectively a repayment of the non-Housing Revenue Account (HRA) borrowing need (there is no statutory requirement to reduce the HRA CFR). This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

The total CFR can also be reduced by:

- the application of additional capital financing resources (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

The Council's 2017/18 MRP Policy (as required by MHCLG Guidance) was approved as part of the Treasury Management Strategy Report for 2017/18 on 21st February 2017.

The Council's CFR for General Fund and the HRA for the year are shown below, and represent a key prudential indicator.

CFR: General Fund	31st March 2017 Actual £m	31st March 2018 Budget £m	31st March 2018 Actual £m
Opening balance	1.001	1.943	**0.943**
Add unfinanced capital expenditure (as above)	-	-	**-**
Less MRP/VRP	(0.058)	(0.058)	**(0.058)**
Less PFI & finance lease repayments	-	-	**-**
Closing balance	0.943	1.885	**0.885**

CFR: HRA	31st March 2017 Actual £m	31st March 2018 Budget £m	31st March 2018 Actual £m
Opening balance	68.041	70.283	**68.041**
Add unfinanced capital expenditure (as above)	-	4.972	**-**
Less MRP/VRP	-	-	**-**
Less PFI & finance lease repayments	-	-	**-**
Closing balance	68.041	75.255	**68.041**

Borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit.

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 (2016/17) plus the estimates of any additional capital financing requirement for the current (2017/18) and next two financial years. 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 2017/18. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

Gross borrowing and the CFR	31st March 2017 Actual £m	31st March 2018 Budget £m	31st March 2018 Actual £m
Gross borrowing position	63.060	65.060	63.060
CFR	68.984	77.140	68.926

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 are 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.

Borrowing Limits	GF £m	HRA £m	Total £m
Authorised limit	4.885	79.407	84.292
Maximum gross borrowing position	-	65.060	65.060
Operational boundary	-	65.060	65.060
Average gross borrowing position	-	63.060	63.060
Budgeted financing costs as a proportion of net revenue stream %	(0.95)	39.23	38.27
Actual financing costs as a proportion of net revenue stream %	(2.84)	38.19	35.35

3. Treasury Position as at 31st March 2018

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

General Fund	31st March 2017 Principal £m	Rate/ Return %	Average Life yrs	31st March 2018 Principal £m	Rate/ Return %	Average Life yrs
Total debt	**-**	**-**	**-**	**-**	**-**	**-**
CFR	***0.943***	**-**	**-**	***0.885***	**-**	**-**
Over / (under) borrowing	***(0.943)***	**-**	**-**	***(0.885)***	**-**	**-**
Investments:						
- in house	25.010	0.60	-	32.334	0.54	-
Total investments	***25.010***	***0.60***	**-**	***32.334***	***0.54***	**-**

HRA	31st March 2017 Principal £m	Rate/ Return %	Average Life yrs	31st March 2018 Principal £m	Rate/ Return %	Average Life yrs
Fixed rate funding:						
-PWLB	63.060	4.26	37.74	63.060	4.05	36.74
Total debt	***63.060***	***4.26***	***37.74***	***63.060***	***4.05***	***36.74***
CFR	***68.041***	**-**	**-**	***68.041***	**-**	**-**
Over / (under) borrowing	***(4.981)***	**-**	**-**	***(4.981)***	**-**	**-**
Investments:						
- in house	26.201	0.60	-	28.471	0.54	-
Total investments	***26.201***	***0.60***	**-**	***28.471***	***0.54***	**-**

Maturity Structures

The maturity structure of the debt portfolio was as follows:

Duration	31st March 2017 Actual £m	2017/18 original limits %	31st March 2018 Actual £m
Under 12 months	-	20	**-**
12 months and within 24 months	-	20	**-**
24 months and within 5 years	-	25	**-**
5 years and within 10 years	-	75	**-**
10 years and within 20 years	5	100	**5**
20 years and within 30 years	-		**-**
30 years and within 40 years	22		**30**
40 years and within 50 years	36		**28**

Investments - All investments held by the Council were invested for under one year.

Investment and borrowing rates

- Investment returns remained low during 2017/18 but were on a gently rising trend in the second half of the year.
- The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this was kept under review to avoid incurring higher borrowing costs in the future when this authority may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt;
- A cost of carry remained during the year on any new long-term borrowing as it would have caused a temporary increase in cash balances which would have incurred a revenue cost – the difference between borrowing costs and investment returns.

Borrowing strategy

The Council maintained an under-borrowed position. This meant that the capital borrowing need (the Capital Financing Requirement), was not fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow was used as a temporary measure. This strategy was prudent as investment returns were low and counterparty risk was still an issue that needed to be considered.

Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Executive Director Finance therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risks

- if it had been felt that there was a significant risk of a sharp FALL in long and short term rates, (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings would have been postponed, and potential rescheduling from fixed rate funding into short term borrowing would have been considered.

- if it had been felt that there was a significant risk of a much sharper RISE in long and short term rates than initially expected, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position would have been re-appraised. Most likely, fixed rate funding would have been drawn whilst interest rates were lower than they were projected to be in the next few years.

The exposure to fixed and variable rates (based on net debt) was as follows:

Rate Type	31st March 2017 Actual £m	31st March 2018 Actual £m
Fixed rate - principal	33.242	28.740
Variable rate - interest	-	-

4. The Strategy for 2017/18

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 31st 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.

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.

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 Economy and Interest Rates

UK. The outcome of the EU referendum in June 2016 resulted in a gloomy outlook and economic forecasts from the Bank of England based around an expectation of a major slowdown in UK GDP growth, particularly during the second half of 2016, which was expected to push back the first increase in Bank Rate for at least three years. Consequently, the Bank responded in August 2016 by cutting Bank Rate by 0.25% to 0.25% and making available over £100bn of cheap financing to the banking sector up to February 2018. Both measures were intended to stimulate growth in the economy. This gloom was overdone as the UK economy turned in a G7 leading growth rate of **1.8% in 2016**, (actually joint equal with Germany), and followed it up with another **1.8% in 2017**, (although this was a comparatively weak result compared to the US and EZ).

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; quarter 1 came in at +0.3% (+1.7% y/y) and quarter 2 was +0.3% (+1.5% y/y), which meant that growth in the first half of 2017 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 in quarter 3 to 0.5% before dipping slightly to 0.4% in quarter 4.

Consequently, market expectations during the autumn rose significantly that the MPC would be heading in the direction of imminently raising Bank Rate. The **MPC meeting of 14th September** provided a shock to the markets with a sharp increase in tone in the minutes where the MPC considerably hardened their wording in terms of needing to raise Bank Rate very soon. The **2nd November MPC quarterly Inflation Report meeting** duly delivered on this warning by withdrawing the 0.25% emergency rate cut which had been implemented in August 2016. Market debate then moved on as to whether this would be a one and done move for maybe a year or more by the MPC, or the first of a series of increases in Bank Rate over the next 2-3 years. The MPC minutes from that meeting were viewed as being dovish, i.e. there was now little pressure to raise rates by much over that time period. In particular, the GDP growth forecasts were pessimistically weak while there was little evidence of building pressure on wage increases despite remarkably low unemployment. The MPC forecast that CPI would peak at about 3.1% and chose to look through that breaching of its 2% target as this was a one off result of the devaluation of sterling caused by the result of the EU referendum. The inflation forecast showed that the MPC expected inflation to come down to near the 2% target over the two to three year time horizon. So this all seemed to add up to cooling expectations of much further action to raise Bank Rate over the next two years.

However, GDP growth in the second half of 2017 came in stronger than expected, while in the new year there was evidence that wage increases had started to rise. The **8th February MPC meeting** minutes therefore revealed another sharp hardening in MPC warnings focusing on a reduction in spare capacity in the economy, weak increases in productivity, higher GDP growth forecasts and a shift of their time horizon to focus on the 18 – 24 month period for seeing inflation come down to 2%.

(CPI inflation ended the year at 2.7% but was forecast to still be just over 2% within two years.) This resulted in a marked increase in expectations that there would be another Bank Rate increase in May 2018 and a bringing forward of the timing of subsequent increases in Bank Rate. This shift in market expectations resulted in **investment rates** from 3 – 12 months increasing sharply during the spring quarter.

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 year, rather than longer term yields.

As for **equity markets**, the FTSE 100 hit a new peak near to 7,800 in early January before there was a sharp selloff in a number of stages during the spring, replicating similar developments in US equity markets.

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. However, **sterling** did suffer a sharp devaluation against most other currencies, although it has recovered about half of that fall since then. Brexit negotiations have been a focus of much attention and concern during the year but so far, there has been little significant hold up to making progress.

The **manufacturing sector** has been the bright spot in the economy, seeing stronger growth, particularly as a result of increased demand for exports. It has helped that growth in the EU, our main trading partner, has improved significantly over the last year. However, the manufacturing sector only accounts for around 11% of GDP so expansion in this sector has a much more muted effect on the average total GDP growth figure for the UK economy as a whole.

EU. Economic growth in the EU, (the UK's biggest trading partner), was lack lustre for several years after the financial crisis despite the ECB eventually cutting its main rate to -0.4% and embarking on a massive programme of quantitative easing to stimulate growth. However, growth eventually picked up in 2016 and subsequently gathered further momentum to produce an overall GDP figure for 2017 of 2.3%. Nevertheless, despite providing this massive monetary stimulus, the ECB is still struggling to get inflation up to its 2% target and in March, inflation was still only 1.4%. It is, therefore, unlikely to start an upswing in rates until possibly towards the end of 2019.

USA. Growth in the American economy was volatile in 2015 and 2016. 2017 followed that path again with quarter 1 at 1.2%, quarter 2 3.1%, quarter 3 3.2% and quarter 4 2.9%. The annual rate of GDP growth for 2017 was 2.3%, up from 1.6% in 2016. Unemployment in the US also fell to the lowest level for 17 years, reaching 4.1% in October to February, while wage inflation pressures, and inflationary pressures in general, have been building. The Fed has been the first major western central bank to start on an upswing in rates with six increases since the first one in December 2015 to lift the central rate to 1.50 – 1.75% in March 2018. There could be a further two or three increases in 2018 as the Fed faces a challenging situation with GDP growth trending upwards at a time when the recent Trump fiscal stimulus is likely to increase growth further, consequently increasing inflationary pressures in an

economy which is already operating at near full capacity. In October 2017, the Fed also became the first major western central bank to make a start on unwinding quantitative easing by phasing in a gradual reduction in reinvesting maturing debt.

Chinese economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus, and medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems.

Japan. GDP growth has been improving to reach an annual figure of 2.1% in quarter 4 of 2017. However, it is still struggling to get inflation up to its target rate of 2% despite huge monetary and fiscal stimulus, although inflation has risen in 2018 to reach 1.5% in February. It is also making little progress on fundamental reform of the economy.

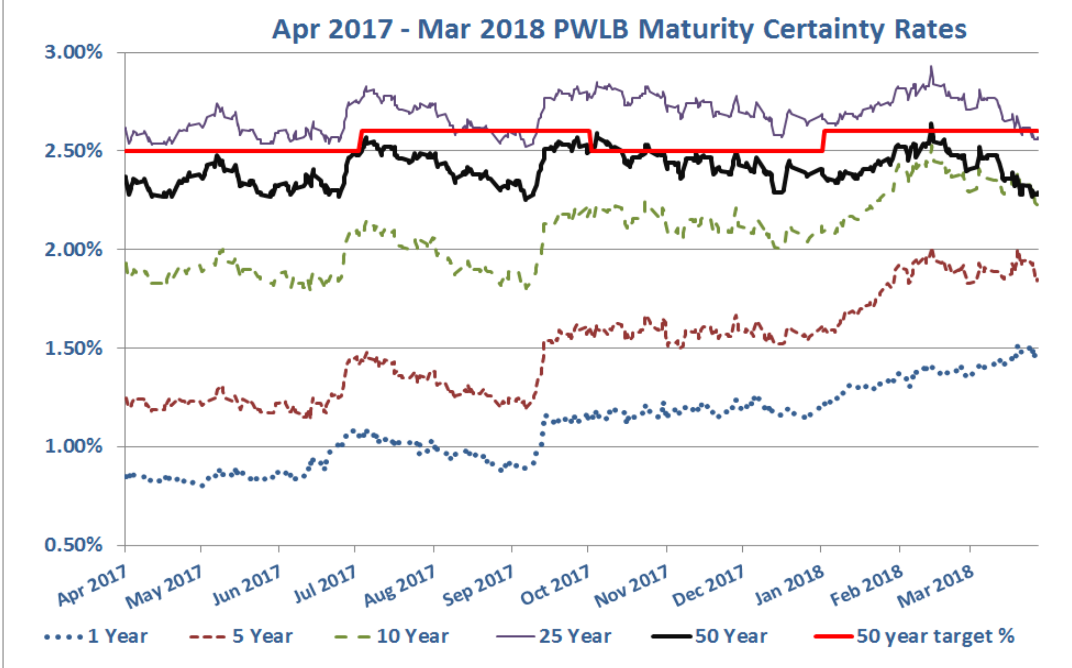
6. Borrowing Rates in 2017/18

PWLB certainty maturity borrowing rates

As depicted in the graph and tables below and in Appendix 2, PWLB 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.

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

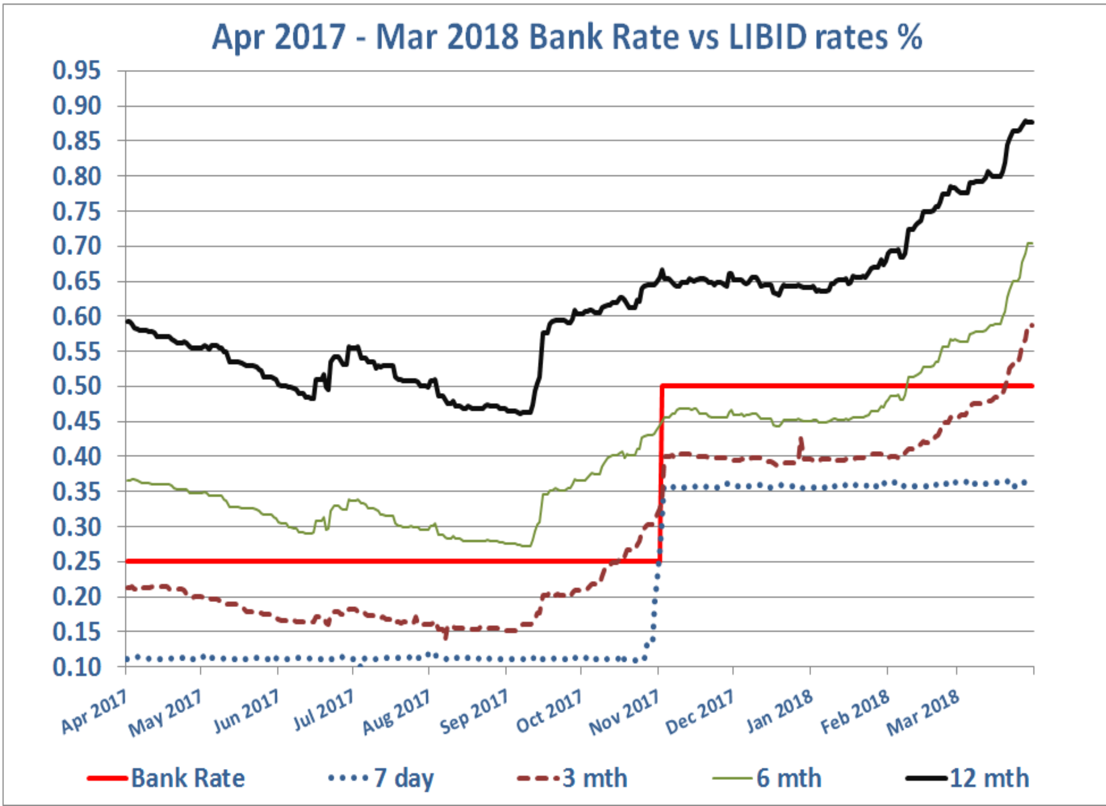
Treasury Borrowing
Due to investment concerns, both counterparty risk and low investment returns, no borrowing was undertaken during the year.

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

Investment 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 2nd November 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 28th February 2018.



9. Investment Outturn for 2017/18

Investment Policy – the Council's investment policy is governed by MHCLG guidance, which has been implemented in the annual investment strategy approved by the Council on 21st February 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, bank share prices etc).

The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties. However, on two occasions during 2017/18 the approved counterparty limits within the Annual Investment Strategy were exceeded:

- The first occurred on 22nd December 2017 when early payments of business rates resulted in £1.696m being held within the Lloyds Bank account, which exceeded the approved limit of £1m by £696k for a period over the weekend and Christmas bank holiday.
- The second occurred on 2nd January 2018 when the repayment of a £2m investment resulted in £2.048m being held in the Lloyds Bank account, exceeding the approved limit by £1.048m overnight.

Resources – the Council's cash balances comprise revenue and capital resources and cash flow monies. The Council's core cash resources comprised the following:

Balance Sheet Resources General Fund	31st March 2017 £m	31st March 2018 £m
Balances	6.588	**6.918**
Earmarked Reserves	5.725	**5.888**
Provisions	1.905	**1.545**
Usable Capital Receipts	9.049	**17.001**
Capital Grants Unapplied	0.048	**0.048**
Total GF	23.315	**31.4**

Balance Sheet Resources HRA	31st March 2017 £m	31st March 2018 £m
Balances	6.353	**6.824**
Earmarked Reserves	14.513	**15.572**
Provisions	-	**-**
Usable Capital Receipts	3.56	**5.252**
Total HRA	24.426	**27.648**

Total Authority Resources	47.741	**59.048**

Investments held by the Council – the Council maintained an average balance of £61.3m of internally managed funds. The internally managed funds earned an average rate of return of 0.54%. The comparable performance indicator is the average 7-day LIBID rate which was 0.22%. This compared with a budget assumption of £50.3m investment balances earning an average rate of 0.50%.

10. Performance Measurement

One of the key requirements in the Code is the formal introduction of performance measurement relating to investments, debt and capital financing activities. Whilst investment performance criteria have been well developed and universally accepted, debt performance indicators continue to be a more problematic area with the traditional average portfolio rate of interest acting as the main guide (as incorporated in the table in section 3). The Council's performance indicators were set out in the Annual Treasury Management Strategy Statement.

This service has set the following local performance indicator:

- *Average external interest receivable in excess of 3 month LIBID rate;*

  Whilst the assumed benchmark for local authorities is the 7 day LIBID rate, a higher target is set for internal performance.

  The actual return of 0.54% compared to the average 3 month LIBID of 0.29% (0.25% above target).

CIPFA Benchmarking Club

The Council is a member of the CIPFA Treasury Management Benchmarking Club which is a means to assess our performance for the year against other members.

11. Other Issues

Revised CIPFA Codes

In December 2017 CIPFA issued a revised Treasury Management Code and Cross Sectoral Guidance Notes, and a revised Prudential Code. A particular focus of these revised codes is non-treasury investments, including the purchase of property to generate income, which may involve external borrowing or the use of existing cash balances. The codes are effective from 2018/19.

MHCLG Investment and Minimum Revenue Provision (MRP) Guidance

Revised guidance was issued by MHCLG in February 2018. Key issues include amendments to the definition of an investment, so that it now covers all financial assets and other non-financial assets that an authority holds primarily to generate returns, such as investment portfolios; and the proviso that authorities should not borrow in advance of need purely to profit from the investment of extra sums borrowed. Additional disclosures are also required in terms of risk management around investments. The investment guidance and requirements with regard to changes to MRP calculations are effective from 2018/19.

Markets in Financial Instruments Directive II (MIFID II)

MIFID II is the EU legislation that regulates firms who provide services to clients linked to financial instruments, and this has recently been revised to strengthen consumer protection and improve the functioning of markets in light of the 2008 financial crisis. Under these reforms effective 3rd January 2018, all local authorities are classified as retail counterparties and have to consider whether to opt up to professional status and for which types of investment. This Council has over £10m in investments and meets the criteria as a professional counterparty, we have opted up to professional status, so that we may continue to use the full range of investments, for example Money Market Funds (MMFs).

Investment in Property Funds

Investment in property funds was included within the Commercial Investment and Regeneration Strategy, with the aim of generating improved returns of c.4-5% p.a. (plus asset growth) being long term investments of between 5 – 10 years (minimum) in order to make the necessary returns (after set up costs).

Utilising the capital receipt proceeds of the sale of the Golf Course, it is envisaged that approx. £12m will be available for long-term investment in a number of property funds. To this end, during the year, the Council undertook a Property Fund Manager selection exercise, appointing Link Asset Services to provide support and advice in the identification and selection of suitable UK-focussed property funds. Full details of the selection process were included in Link Asset Services's report presented to Members 21st February 2018.

The result of the process is that the Council will look to splitting investment across the following six funds:-

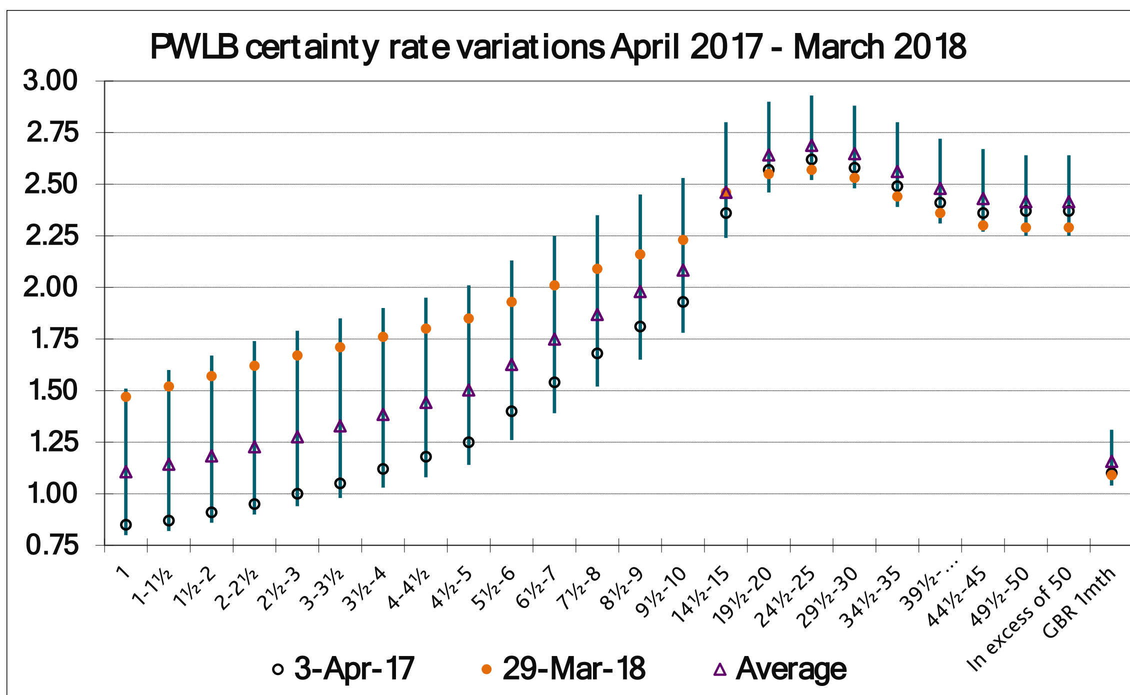
BlackRock UK Property Fund
Hermes Property Unit Trust
Lothbury Property Trust
Schroder UK Real Estate Fund
The Local Authorities Property Fund (CCLA)
Threadneedle Property Unit Trust

This will provide the Council with a range of approaches to property fund investment, diversification across a number of funds, rather than a concentration in only one or two options, as well as the ability to take advantage of entering a number of funds via the secondary market, whereby the Council would be purchasing units from investors looking to exit the particular fund, and may potentially gain access to a fund at a lower level of cost than via the primary route.

PRUDENTIAL AND TREASURY INDICATORS APPENDIX 1

1. PRUDENTIAL INDICATORS	2016/17	2017/18	2017/18
Extract from budget and rent setting report	**Actual**	**Original**	**Actual**
Capital Expenditure	**£m**	**£m**	**£m**
Non - HRA	1.408	5.397	1.545
HRA	7.351	25.988	7.655
TOTAL	8.759	31.385	9.200
Ratio of financing costs to net revenue stream	**%**	**%**	**%**
Non - HRA	(3.49)	(0.95)	(2.84)
HRA	37.84	39.23	38.19
Gross borrowing requirement General Fund	**£m**	**£m**	**£m**
brought forward 1 April	-	-	-
carried forward 31 March	-	-	-
in year borrowing requirement	-	-	-
Gross borrowing requirement HRA	**£m**	**£m**	**£m**
brought forward 1 April	63.060	65.060	63.060
carried forward 31 March	63.060	65.060	63.060
in year borrowing requirement	-	4.972	-
	£m	**£m**	**£m**
Gross debt	63.060	65.060	63.060
Capital Financing Requirement	**£m**	**£m**	**£m**
Non – HRA	0.943	1.885	0.885
HRA	68.041	75.255	68.041
TOTAL	68.984	77.140	68.926
Annual change in Capital Financing Requirement	**£m**	**£m**	**£m**
Non – HRA	(0.058)	(0.058)	(0.058)
HRA	-	4.972	-
TOTAL	(0.058)	4.914	(0.058)

2. TREASURY MANAGEMENT INDICATORS	2016/17	2017/18	2017/18
	Actual	Original	Actual
	£m	£m	£m
Authorised Limit for external debt - General Fund			
borrowing	9.705	4.885	4.885
other long term liabilities	3.000	-	-
TOTAL	12.705	4.885	4.885
Authorised Limit for external debt - HRA			
borrowing	79.407	79.407	79.407
other long term liabilities	-	-	-
TOTAL	79.407	79.407	79.407
Operational Boundary for external debt - General Fund	£m	£m	£m
borrowing	0.000	0.000	0.000
other long term liabilities	-	-	-
TOTAL	0.000	0.000	0.000
Operational Boundary for external debt - HRA	£m	£m	£m
borrowing	65.060	65.060	65.060
other long term liabilities	-	-	-
TOTAL	65.060	65.060	65.060
Actual external debt	£m	£m	£m
	63.060	65.060	63.060
Maximum HRA debt limit	£m	£m	£m
	79.407	79.407	79.407



	1	1-1.5	2.5-3	3.5-4	4.5-5	9.5-10	24.5-25	49.5-50	1 month variable
3/4/17	0.850%	0.870%	1.000%	1.120%	1.250%	1.930%	2.620%	2.370%	1.100%
29/3/18	1.470%	1.520%	1.670%	1.760%	1.850%	2.230%	2.570%	2.290%	1.090%
High	1.510%	1.600%	1.790%	1.900%	2.010%	2.530%	2.930%	2.640%	1.310%
Low	0.800%	0.820%	0.940%	1.030%	1.140%	1.780%	2.520%	2.250%	1.040%
Average	1.107%	1.143%	1.276%	1.384%	1.503%	2.083%	2.688%	2.415%	1.157%
Spread	0.710%	0.780%	0.850%	0.870%	0.870%	0.750%	0.410%	0.390%	0.270%
High date	21/03/2018	21/03/2018	21/03/2018	21/03/2018	15/02/2018	15/02/2018	15/02/2018	15/02/2018	21/03/2018
Low date	03/05/2017	03/05/2017	30/05/2017	15/06/2017	15/06/2017	15/06/2017	08/09/2017	08/09/2017	04/04/2017

	1 Year	5 Year	10 Year	25 Year	50 Year
1/4/17	0.85%	1.25%	1.93%	2.62%	2.37%
31/3/18	1.47%	1.85%	2.23%	2.57%	2.29%
Low	0.80%	1.14%	1.78%	2.52%	2.25%
Date	03/05/2017	15/06/2017	15/06/2017	08/09/2017	08/09/2017
High	1.51%	2.01%	2.53%	2.93%	2.64%
Date	21/03/2018	15/02/2018	15/02/2018	15/02/2018	15/02/2018
Average	1.11%	1.50%	2.08%	2.69%	2.41%

Money market investment rates 2017/18

	7 day	1 month	3 month	6 month	1 year
1/4/17	0.111	0.132	0.212	0.366	0.593
31/3/18	0.364	0.386	0.587	0.704	0.878
High	0.366	0.390	0.587	0.704	0.879
Low	0.099	0.122	0.140	0.273	0.461
Average	0.215	0.233	0.286	0.401	0.606
Spread	0.267	0.268	0.447	0.432	0.418
High date	27/2/18	22/3/18	29/3/18	29/3/18	28/3/18
Low date	4/7/17	10/8/17	7/8/17	7/9/17	6/9/17