ITEM NO. 7.1

Report of:	**Head of Finance**
Contact Officer:	**Bob Kean**
Telephone No:	**01543 464 334**
Portfolio Leader:	**Leader of the Council**
Key Decision:	**No**
Report Track:	**Audit & Governance Cttee: 26/07/18 and Council: 26/09/18**

AUDIT & GOVERNANCE COMMITTEE

26 JULY 2018

ANNUAL TREASURY MANAGEMENT REPORT 2017/18

1 Purpose of Report

1.1 To update members on treasury management activity and performance during the 2017/18 financial year.

2 Recommendations

2.1 To note the annual treasury management report for 2017/18.

2.2 To approve the actual 2017/18 prudential and treasury indicators set out in the **APPENDIX**.

3 Key Issues and Reasons for Recommendation

3.1 Treasury management activity and performance during the 2017/18 financial year.

4 Relationship to Corporate Priorities

4.1 Treasury management and investment activity link in with all of the Council's priorities and spending plans.

5 Report Detail

Background

5.1 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).

5.2 During 2017/18 the minimum reporting requirements were that the full Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 08/02/2017)
- a mid-year (minimum) treasury update report (A&G 05/12/2017)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

5.3 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.

5.4 This Council confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Audit and Governance Committee before they were reported to the full Council. Training has been undertaken by members of the Audit and Accounts Committee and further training will be arranged as required.

The Economy and Interest Rates

5.5 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%. 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. 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. 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.

5.6 **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.

Overall Treasury Position as at 31 March 2018

5.7 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 £'000	Rate/ Return	Average Life (yrs.)	31 March 2018 Principal £'000	Rate/ Return	Average Life (yrs.)
Total debt (PWLB)	84,205	4.18%	38.4	81,605	3.89%	36.68
CFR	95,769			94,924		
Over / (under) borrowing	(11,564)			(13,319)		
Total investments	18,600	0.57%	0.36	11,900	0.37%	0.27
Short term borrowing	(2,600)			0		
Net investments	16,000			11,900		
Net debt	65,605			69,705		

Strategy for 2017/18

5.8 The expectation for interest rates within the treasury management strategy for 2017/18 anticipated low but rising Bank Rate, and gradual rises in medium and longer term fixed borrowing rates during 2017/18. 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.

5.9 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.

5.10 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.

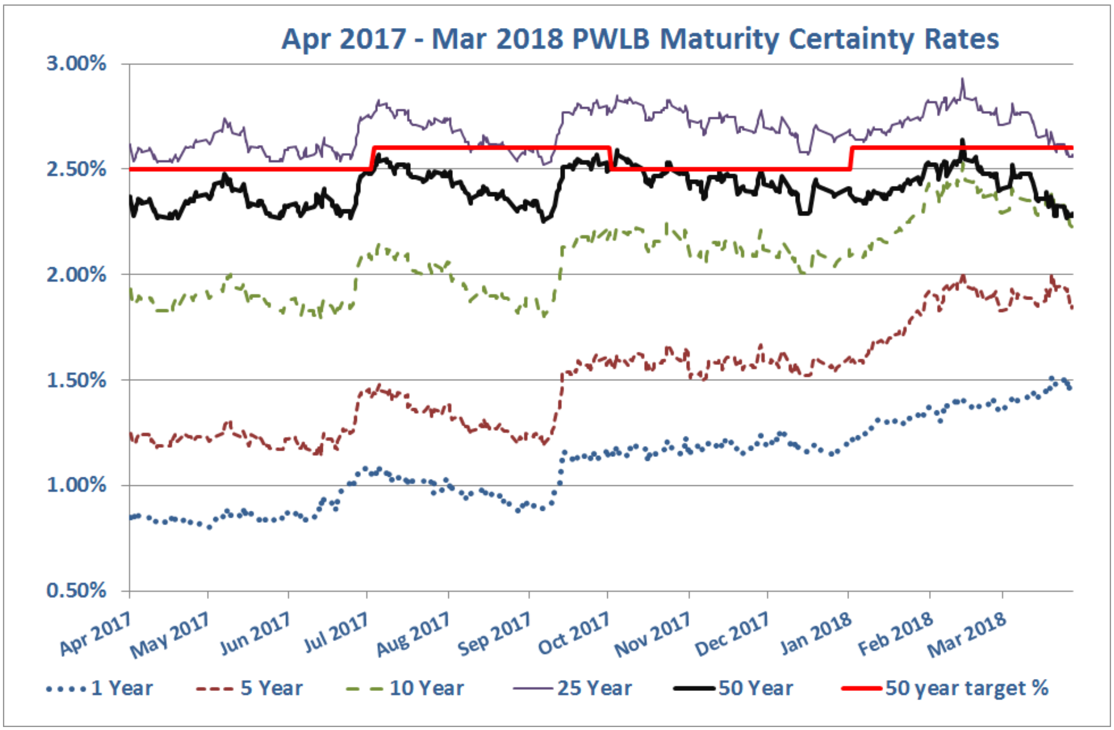
Borrowing Requirement

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

TABLE 2	31-Mar-17 Actual £'000	31-Mar-18 Budget £'000	31-Mar-18 Actual £'000
CFR (Housing)	81,518	80,054	79,953
CFR (GF)	14,251	13,866	13,866
CFR (Finance Leases)			1,105
CFR (Total)	95,769	93,921	94,924

Borrowing Rates in 2017/18

5.12 **PWLB certainty maturity borrowing rates -** As depicted in the graph below, 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.

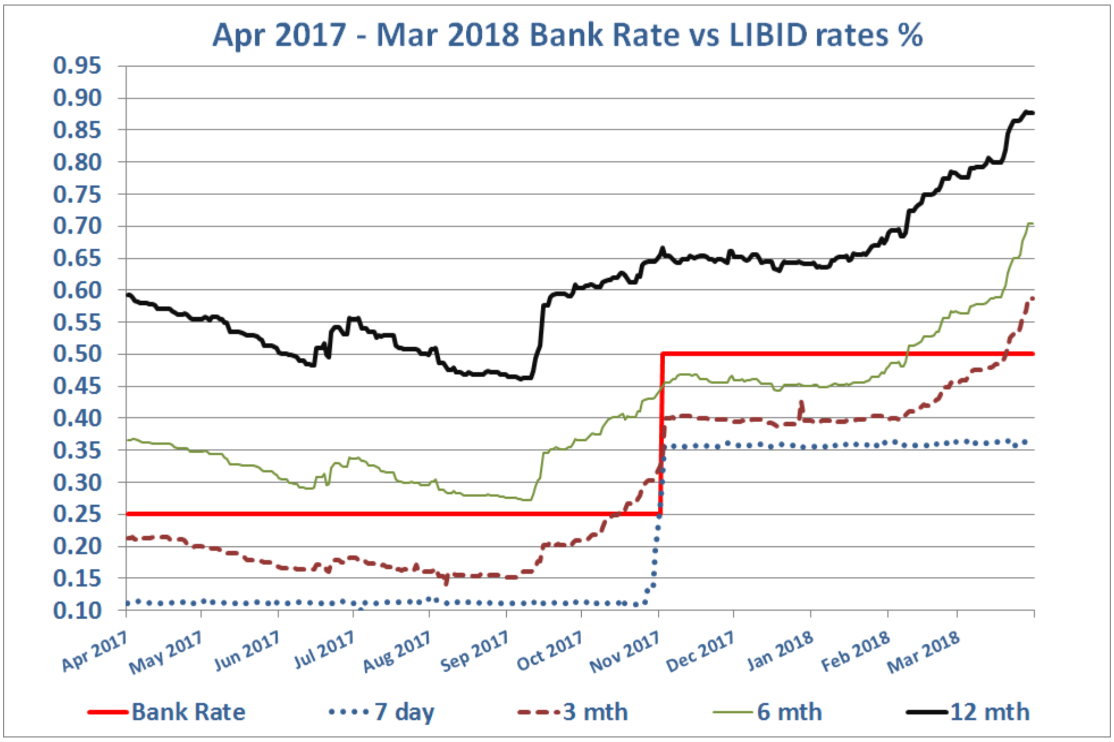


Borrowing Outturn for 2017/18

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

Investment Rates in 2017/18

5.14 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 2.11.17 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 28.2.18.



Investment Outturn for 2017/18

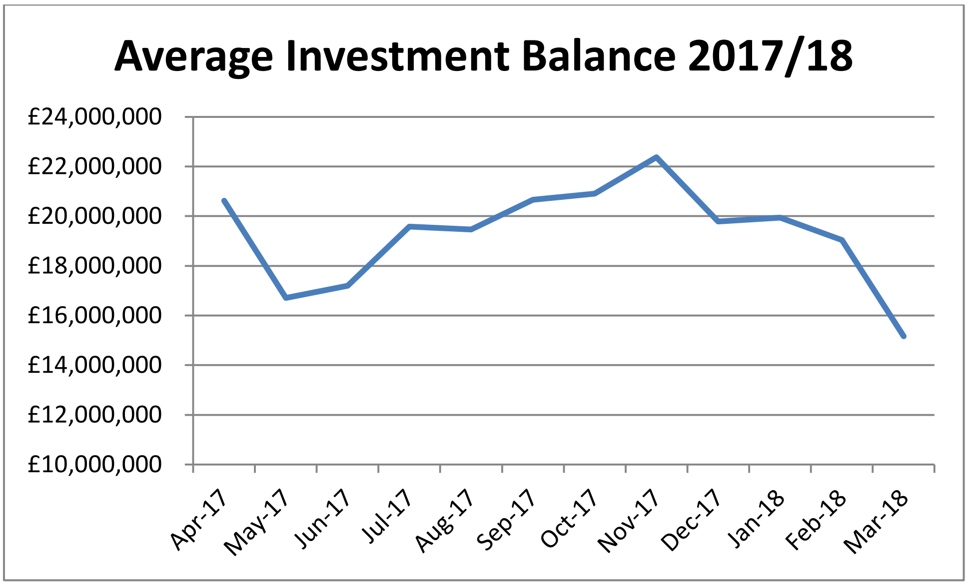
5.15 **Investment Policy** - the Council's investment policy is governed by MHCLG guidance, which has been implemented in the annual investment strategy approved by the Council on 08/02/2017. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data, (such as rating outlooks, credit default swaps, bank share prices etc).

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

5.17 **Investments held by the Council** - the Council's investments as at 31 March 2018 are set out in the following table:-

Counterparty	Start Date	Maturity	Value (£)	Rate (%)
Standard Life		Money Market	4,900,000	0.46
Federated		Money Market	2,000,000	0.46
The Royal Bank of Scotland	11/09/2017	10/09/2018	2,000,000	0.56
Helaba Bank	16/11/2017	16/05/2018	2,500,000	0.52
Barclays Bank PLC		Call Account	500,000	0.05
			11,900,000	

5.18 The Council maintained an average balance of £21.3m of internally managed funds. The internally managed funds earned an average rate of return of 0.37%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.21%. The chart below illustrates the movement in the level of investments held by the Council at each month end during the year.



5.19 Although the average rate of return exceeded the benchmark, overall investment earnings of £140,215 were less than predicted when compared to the original budget of £158,000, set in February 2017.

6 Implications

6.1 Financial

The financial implications have been referred to throughout the report.

6.2 Legal

The legal implications have been referred to throughout the report.

6.3 **Human Resources**

There are no human resource implications arising from this report.

6.4 **Section 17 (Crime Prevention)**

There are no implications arising from this report.

6.5 **Human Rights Act**

There are no identified implications in respect of the Human Rights Act 1998 arising from this report.

6.6 **Data Protection**

There are no implications arising from this report.

6.7 **Risk Management**

Treasury management is a high risk area due to the large amounts of money dealt with on a daily basis. However, the Council has a Treasury Policy and Strategy in place which is approved each year for the following 12 months. The Council also has advice on investment and lending from the leading company in the field and has instituted a strict control and delegation of duties regime which reduces risk to a minimum.

6.8 **Equality & Diversity**

There are no identified implications arising form this report.

6.9 **Best Value**

The strategy ensures that best value is provided to the Council.

7 Appendices to the Report

Appendix 1: 2016-17 Prudential and Treasury Indicators

Previous Consideration

None

Background Papers

Available in Financial Services.

ITEM NO. 7.

ITEM NO. 7.8

Appendix 1

AUDIT & GOVERNANCE COMMITTEE
26 JULY 2018
ANNUAL TREASURY MANAGEMENT REPORT 2017/18

1. PRUDENTIAL INDICATORS	2016/17	2017/18	2017/18
	Actual	Estimate	Actual
	£'000	£'000	£'000
Capital Expenditure (HRA)	8,999	10,634	10,039
Capital Expenditure (GF)	3,207	3,421	2,560
Notional Capital expenditure – Finance Leases			1,312
Ratio of financing costs to net revenue stream (HRA)	18.60%	25.20%	24.6%
Ratio of financing costs to net revenue stream (GF)	3.90%	3.70%	3.6%
Gross borrowing requirement (GF) - Finance Leases	0	0	1,105
Gross debt	84,205	81,708	81,605
Capital Financing Requirement as at 31 March (HRA)	81,518	80,054	79,953
Capital Financing Requirement as at 31 March (GF)	14,251	13,866	14,971
Annual change in Cap. Financing Requirement (HRA)	-249	-1,464	-1,565
Annual change in Cap. Financing Requirement (GF)	-401	-385	-385
Annual Change in CFR - Finance Leases			1,105
2. TREASURY MANAGEMENT INDICATORS			
Authorised Limit for external debt -	108,284	111,410	111,410
Operational Boundary for external debt	96,784	99,910	99,110
Actual external debt	84,205	81,708	81,605

Maturity structure of fixed rate borrowing during 2017/18	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%