

Annual Treasury Management Report 2017/18

as at 4/6/18 - LT



1. Introduction and Background

This Council is required through regulations issued under the Local Government Act 2003 to produce an annual treasury report reviewing treasury management 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 that the full Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council - February 2017)
- a mid year (minimum) treasury update report (Council – December 2017)
- an annual report following the year describing the activity compared to the strategy (this report)

In addition, the Cabinet has received quarterly treasury management updates as part of the overall financial reporting during the course of the year.

The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is 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 give prior scrutiny of treasury management reports by the Scrutiny (Audit and Value for Money Council Services) Committee before they were reported to the full Council.

2. This Annual Treasury Report Covers

- the council's treasury position as at 31 March 2018;
- the strategy for 2017/18 – a summary;
- Borrowing and Investments outturn
- the economy and interest rates in 2017/18;
- compliance with treasury limits and prudential indicators;
- Icelandic bank defaults and other issues.

3. Treasury Position as at 31 March 2018

The council's debt and investment portfolio is organized by the financial management service in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks with all treasury management activities. Procedures and controls to achieve these objectives are well established through member reporting detailed in the introduction, and through officer activity detailed in the council's treasury management practices.

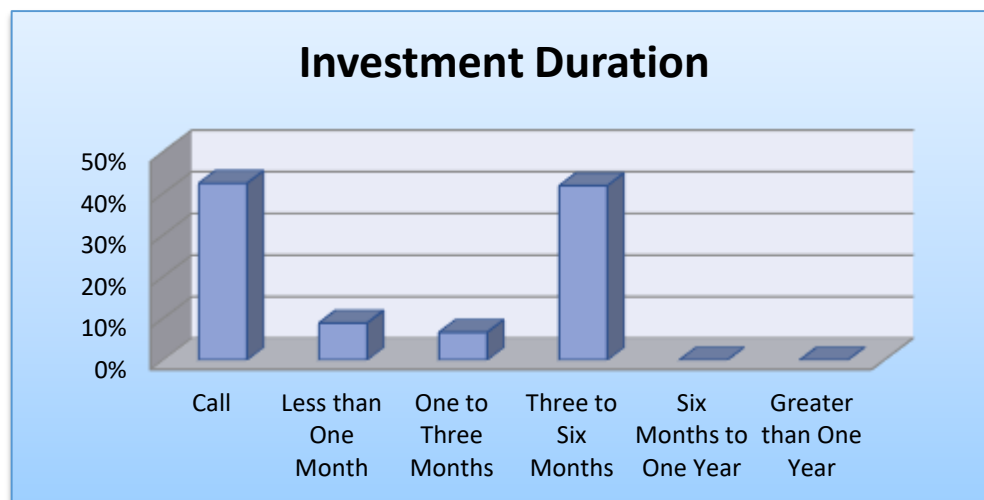
The council's treasury portfolio position (excluding borrowing from finance leases) and the average interest rates on the portfolio as at the beginning and end of the year were as follows:

2016/17 Principal	Average Rate		2017/18 Principal	Average Rate
<u>Borrowing</u>				
£6.4m		- PWLB	£6.4m	
£5.0m		- Market and other	£5.0m	
£11.4m	5.4%	Total Borrowing	£11.4m	5.4%
<u>Investments</u>				
£22.7m	0.5%	Core Deposits	£22.7m	0.5%
£3.0m		Forward Deposit (RBS)	-	
(£0.3m)		Cash and Bank	£0.3m	
£25.4m		Total Investments	£23.0m	

The maturity structure of the **borrowing** was as follows:-

2016/17 Principal		2016/17 Principal
£0.6m	Under 1 Year	£0.6m
£0m	Maturing in 1-2 Years	£0m
£0.2m	Maturing in 2-5 Years	£0.2m
£6.9m	Maturing in 5-10 Years	£6.9m
£3.7m	Maturing in 10-15 Years	£3.7m
£0m	Maturing in excess of 15 Years	£0m
£11.4m	Total	£11.4m

The maturity structure of the **investments at 31st March** was as follows:-



4. The Strategy for 2017-18 - Summary

The Treasury Management Strategy Statement and Annual Investment Strategy for 2017/18 was approved by the Council on 27th February 2017.

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. With this in mind the budget for investment returns during 2017/18 was set at 0.33%. There was an expectation of 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 maintain an under-borrowed position 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.

The capital financing requirement was forecast to continue to fall, with no new expenditure from borrowing planned and both statutory and voluntary reductions reducing the cost of borrowing to the revenue budget.

5. Borrowing Outturn for 2017/18

5.1 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 unfinanced capital expenditure as at the year end.

The council's CFR is not allowed to rise indefinitely. Statutory controls are in place that require the authority to make an annual revenue charge, called the Minimum Revenue Provision (MRP) to reduce the CFR. This is effectively a repayment of non-housing borrowing.

The council's 2017/18 MRP policy (as required by DCLG guidance) was approved as part of the Treasury Management Strategy Statement for 2017/18. The CFR position is set out in the table below:-

CFR	2017/18 Actual £'000	2016/17 Actual £'000
Opening Balance	18,595	20,821
Add unfinanced capital expenditure	-	53
Less MRP	(417)	(441)
Less Voluntary Debt Repayment	(729)	(1,333)
Less finance lease repayments	(511)	(542)
Change in long term debtors	(42)	37
Closing Balance	16,896	18,595

The mid-year update estimated that the CFR would be £16.9m as at 31st March 2018.

Overall the CFR has reduced by £1.7m, which is largely as a result of in year statutory repayments and the decision to repay £0.7m of underlying debt from windfall monies to generate revenue budget savings as part of the MTFS.

The Council's borrowing activity is constrained by affordability, and prudential indicators including the CFR, operational boundary and the authorised limit.

5.2 The Authorised Limit and Operational Boundary

The authorised limit is the “affordable borrowing limit” required by Section 3 of the Local Government Act 2003. 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 level is set at £18.5m to allow some headroom. Periods where the actual position is either above or below the boundary are acceptable subject to the authorised limit not being breached.

2016/17 £'000	Borrowing Limits and Boundaries	2017/18 £'000
23,500	Authorised Limit	21,500
21,500	Operational Boundary	18,500
13,349	Gross Borrowing at 31 st March (inc, Finance Leases)	12,779
11,460	Gross Borrowing at 31 st March (excl. Finance leases)	11,401
18,595	Capital Financing Requirement	16,896

5.3 Short-term Borrowing

It was anticipated that only very limited short-term borrowing would be required to cover temporary cash flow deficits; interest payable would therefore be minimal. This has been the case, with only three occasions for a total of 25 days when short term borrowing was necessary.

5.4 Debt Rescheduling

Debt rescheduling opportunities have been limited in the current economic climate and consequent structure of interest rates. There has not been any restructuring undertaken during 2017/18.

6. Investments Outturn 2017/18

6.1 Investment Policy

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

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

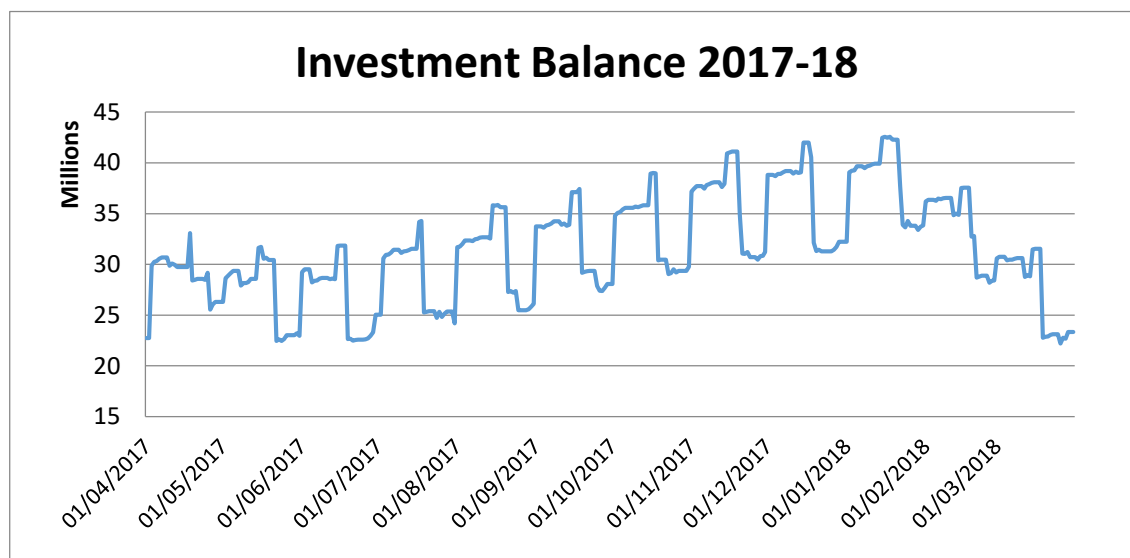
6.2 Investments as at 31st March 2018

The Council's core investments as at 31st March amounted to £23m (excluding Icelandic deposits). These balances were, in the main, held within AAA rated Money Market Funds (£5.4m) and fixed term deposits and call accounts amounting to £12.1m have also been placed with a few UK Banks. With the remainder placed with highly rated counterparties via certificates of deposit. This strategy reflects a continuation of the council's relatively low risk appetite in relation to its investments.

The Council's Investments as at 31st March 2018 were:

Borrower	Principal (£)	Interest Rate	Start Date	Maturity Date
<u>Call Accounts and Money Market Funds</u>				
RBS SIBA	223,430	0.01%		Call
Barclays	3,410,782	0.70%		95 day notice
Insight MMF	3,400,000	0.44%		Call
Federated MMF	2,000,000	0.44%		Call
Santander	3,500,000	0.60%		95 day notice
<u>Fixed Deposits:</u>				
BOS	1,500,000	0.65%	29/03/2018	28/09/2018
BOS	500,000	0.36%	06/10/2017	06/04/2018
BOS	500,000	0.65%	06/11/2017	08/05/2018
Lloyds TSB	1,000,000	0.65%	01/12/2017	01/06/2018
Lloyds TSB	1,500,000	0.36%	04/10/2017	04/04/2018
Nationwide CD	1,500,000	0.32%	13/10/2017	13/04/2017
Nordea CD	1,500,000	0.44%	25/10/2017	25/04/2018
Rabobank CD	1,500,000	0.50%	19/10/2017	19/04/2018
RBS CD	1,000,000	0.60%	04/09/2017	03/09/2018

The chart below illustrates the movement in the level of investments held by the Council throughout the year, with the peak being £42.6m in January and the average being £31m.



During the course of the year and in line with the Treasury Management Strategy the council considered property fund investments. Property fund investments are a long term investment tool which typically generate enhanced rates although there can be short term volatility. Due to accounting changes coming into force from 2018/19 any potential unrealised short term negative volatility would need to be funded in the year it occurs unless central government acted to mitigate the impact of this change. It was therefore agreed to re-consider this at a later date when there is more clarity on the Government’s position.

6.3 Investment Rates

The following table illustrates the rate of return generated by the Council’s Investments for 2017/18, which compares favourably with the benchmark returns:

	Average Rate Year to 31/03/18
ESBC	0.43%
3 Month LIBID Rate	0.29%
6 Month LIBID Rate	0.40%
Base Rate (Average)	0.35%
Budget	0.33%

**LIBID = London Inter Bank Deposit Rate

The ESBC average return for the year exceeds the base rate and other benchmarks.

7. The Economy and Interest Rates

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.

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.

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.

8. Compliance with Treasury Limits

During the financial year the Council operated within the treasury limits and Prudential Indicators set out in the Council's annual Treasury Strategy Statement. The outturn for the Prudential Indicators *is shown in Appendix 1*.

9. Other Treasury Matters

a) Icelandic Bank Defaults

This authority currently has the following investments outstanding in Icelandic banks:

Borrower - Icelandic Exposure	Principal (£)	Interest Rate	Start Date	Maturity Date
Singer	290,000	5.41%		08/10/2008

The administrators for Kaupthing, Singer and Friedlander Ltd made two dividend payments during the financial year. It is currently anticipated that the administration process will continue into 2019 and beyond (Current extension ends October 2018, but the administrators have indicated that a further extension will be requested until 2021).

b) Markets in Financial Instruments Directive II (MiFID II)

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.

c) Revised Codes issued by CIPFA

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.

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.

Appendix 1: Prudential Indicators

PRUDENTIAL INDICATOR	2016/17	2017/18	2017/18
	£'000	£'000	£'000
	Actual outturn	Original Estimate	Actual outturn
Capital Expenditure (a)	1,999	1,117	1,832
Ratio of financing costs to net revenue stream	12.97%	13.83%	14.07%
Capital Financing Requirement as at 31 March (excluding finance leases) (b)	16,706	15,293	15,518
Capital Financing Requirement as at 31 March (including finance leases)	18,595	16,683	16,896
External Debt (excl. Finance leases) (c)	11,460	11,049	11,401
Incremental impact of capital investment decisions	£ p	£ p	£ p
Increase in Council Tax (band D) per annum	0.08	0.01	0.12

- (a) The outturn is higher than the original estimate due to in-year capital approvals, including the Town Hall Office Accommodation etc.
- (b) The outturn is higher than the original estimate due to the timing of the repayment of the GBSLEP loan now expected in 2018/19.
- (c) The original estimate assumed that the GBSLEP Loan in respect of Dove Way would be repaid in 2017/18. It is now likely that this will take place during 2018/19.

PRUDENTIAL INDICATOR	2016/17	2017/18	2017/18
(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	£'000	£'000	£'000
	Actual Outturn	Original	Actual Outturn
Authorised Limit for external debt -			
borrowing	21,500	18,500	18,500
other long term liabilities*	2,000	3,000	3,000
TOTAL	23,500	21,500	21,500
Operational Boundary for external debt -			
Borrowing	19,500	16,500	16,500
other long term liabilities*	2,000	2,000	2,000
TOTAL	21,500	18,500	18,500
Upper limit for fixed rate exposure	9,000	9,000	9,000
Upper limit for variable rate exposure	4,000	4,000	4,000
Upper limit for total principal sums invested for over 1 year	3,000	5,000	5,000

*This provides an allowance for on-balance sheet finance leases, as set out in previous reports.

Maturity structure of new fixed rate borrowing during 2017/18	upper limit	lower limit
under 12 months	85%	0%
12 months and within 24 months	85%	0%
24 months and within 5 years	85%	0%
5 years and within 10 years	90%	0%
10 years and above	90%	0%