ITEM NO. 11

REPORT TO THE COUNCIL MEETING OF 10th DECEMBER 2018

Meeting:	**Council**
Date:	**10th December 2018**
Subject:	**Annual Treasury Management Report and Actual Prudential Indicators 2017/18 and Mid Year Treasury Management Report 2018/19**
Report of:	**Simon Riley, Head of Finance and Corporate Services (S151 Officer)**
Portfolio Holder:	**Councillor Hallam, Financial and Assets Portfolio Holder**
Status:	**Decision**
Relevant Ward(s):	**Not Applicable**

1 Purpose Report

1.1 Treasury Management is an integral part of the Council's finances relating to cash flow management and financing of capital schemes and therefore underpins all of the Council's aims. The annual treasury report is a requirement of the Council's reporting procedures, and covers the treasury management activity for 2017/18. The report also covers the actual Prudential Indicators for 2017/18 in accordance with the requirements of the Prudential Code.

2 Recommendations:

2.1 Council note the Annual Treasury Management Report for 2017/18.

2.2 Council approve the outturn Prudential Indicators for 2017/18.

2.3 Council note the 2018/19 mid year Treasury Management Report

2.4 Council approve the amendment to the MRP Policy set out in Appendix A, Section 8 (d)

3 Summary of Reasons for the Recommendations

3.1 The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management in Local Authorities requires an Annual Treasury Report be brought before Council following the end of the financial year in question.

3.2 The Prudential Code for Capital Finance in Local Authorities, introduced on 1 April 2004, requires that the Council approves the actual Prudential Indicators after the end of the financial year.

4 Impact on Communities

4.1 None arising directly from this report.

5 Key Facts

5.1 The Council's treasury management activities are regulated by a variety of professional codes and statutes and guidance, primarily the Local Government Act 2003 (the Act) which provides the powers to borrow and invest as well as providing controls and limits on this activity. The Act permits the Secretary of State to set limits either on individual authorities or nationally on all authorities, which restrict the amount of borrowing which may be undertaken. No such restrictions were put in place during 2017/18. Statutory instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act. The SI requires the Council to undertake any borrowing activity with regard to CIPFA's Prudential Code for Capital Finance in Local Authorities, and to operate its treasury function in line with guidance laid down in CIPFA's Code of Practice for Treasury Management in the Public Services. Under the Act, the Government has also issued investment guidance in order to structure and regulate the Council's investment activities.

5.2 The CIPFA code provides the following objective with regard to Treasury Management

'*It is important that treasury management policies adequately reflect risk and in particular security, liquidity and yield risk, in that order of importance. No treasury management transaction is without risk and management of risks is the key purpose of the treasury management strategy'*

5.3 The Council has adopted the CIPFA Code of Practice for Treasury Management in the Public Sector (the Code) and operates its treasury management service in compliance with this Code and the above requirements. The prime objective of the treasury management activity is the effective management of risk, and that its borrowing activities are undertaken in a prudent, affordable and sustainable manner.

5.4 The main requirements of the Code are the:

- Creation and maintenance of a Treasury Management Policy Statement setting out the policies and objectives of the Council's treasury management activities;
- Creation and maintenance of Treasury Management Practices which set out the manner in which the Council aims to achieve those policies and objectives;
- Production of an Annual Treasury Strategy Report which covers the forecast activity for the forthcoming financial year;

- Production of an Annual Treasury Management Report which reviews actual activity on the treasury function for the preceding financial year.

5.5 This report is prepared in accordance with the CIPFA Treasury Management Code and Prudential Code. It updates members on treasury management activities in 2017/18 and:

- Presents details of capital financing, borrowing and investment decisions
- Reports on the risk implications of treasury decisions and transactions
- Gives details on the outturn position on treasury management transactions in 2017/18
- Confirms compliance with treasury limits and prudential indicators
- Details the Council's treasury position at the 31 March 2018 with prior year comparators

5.6 Due to low investment returns in 2017/18, the Council continued its policy over the past few years of using internal investments to delay the need to borrow monies to finance the Council's capital spending because of higher rate for borrowing at the current time.

5.7 The Prudential Code requires the Council to set prudential indicators which provide a framework for capital expenditure decision making. It highlights through the prudential indicators the level of capital expenditure, the impact on borrowing and investment levels and the overall controls in place to ensure the activity remains affordable, prudent and sustainable. Within the overall capital expenditure framework there is a clear impact on the Council's treasury management activity, either through increased borrowing levels or the application of investment balances.

5.8 **Economic Background for 2017/18**

5.8.1 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%.

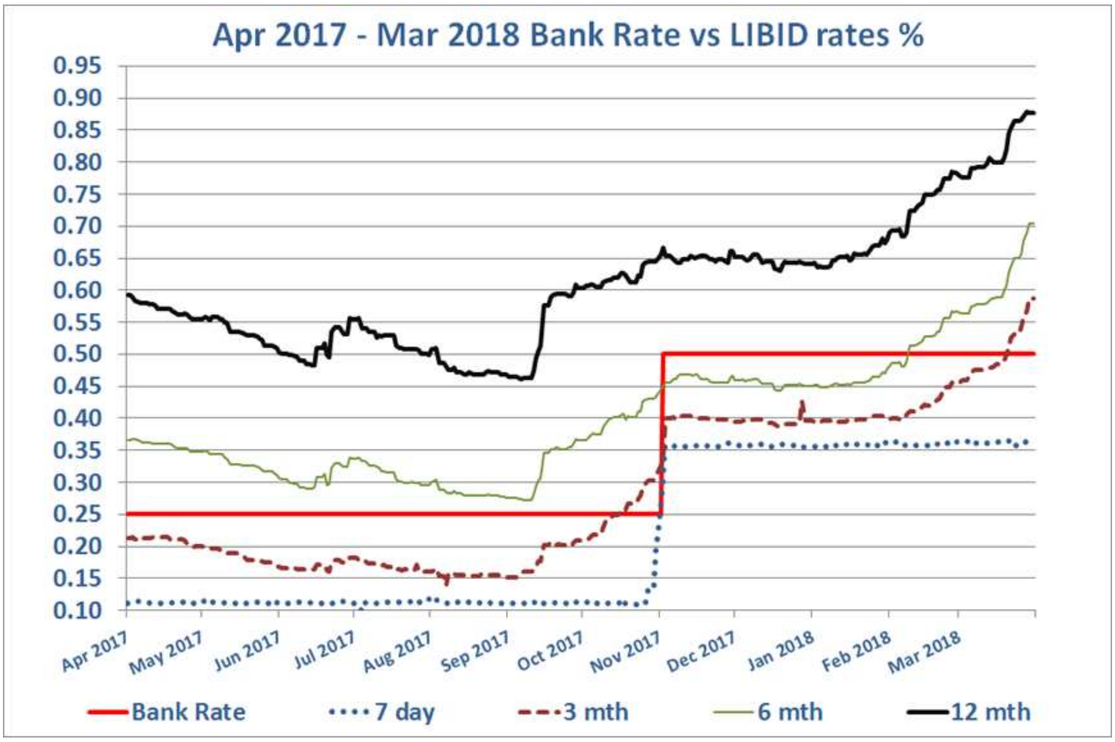
The 8 February MPC meeting minutes then revealed another sharp hardening in MPC warnings on a more imminent and faster pace of increases in Bank Rate than had previously been expected. Market expectations for increases in Bank Rate, therefore, shifted considerably during the second half of 2017-18 and 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.

Investment Rates in 2017/18

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.



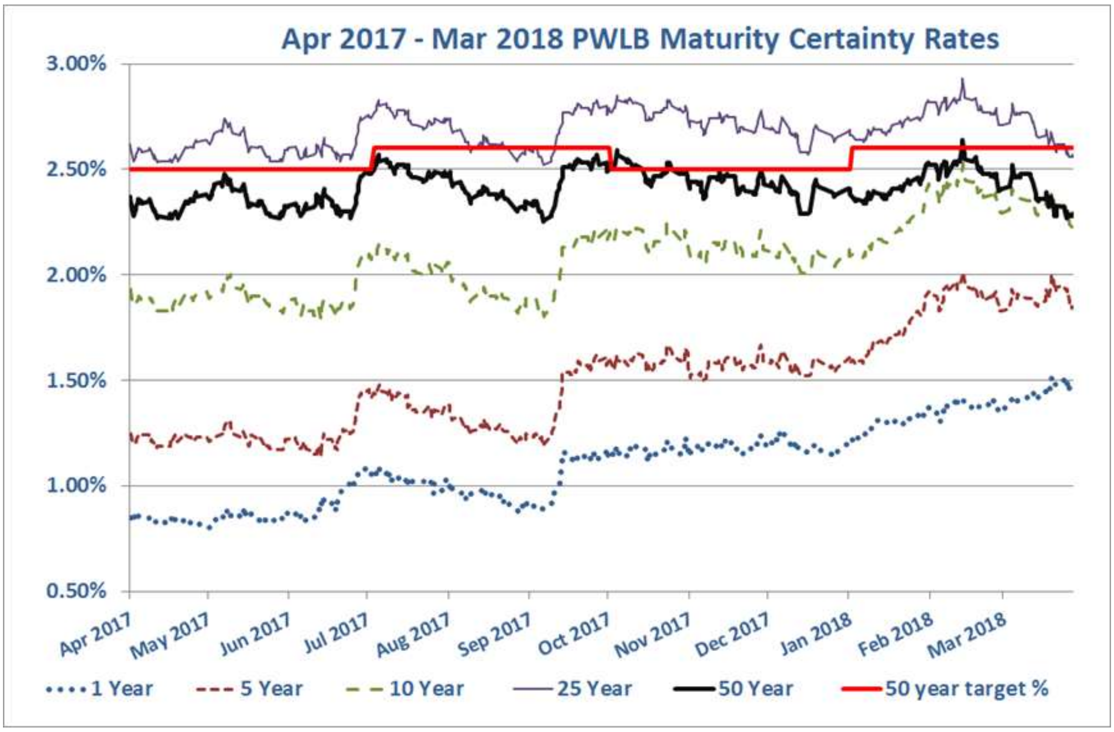
Borrowing Rates in 2017/18

PWLB certainty maturity borrowing rates

As depicted in the graph, 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.



5.9 **Treasury Position as at 31 March 2018**

The treasury position at 31 March 2018 compared with the previous year was:

	31 March 2017		31 March 2018	
	Principal £000	**Average Rate**	**Principal £000**	**Average Rate**
Total Debt	**1,519**	4.91%	**1,508**	4.93%
Total Investments	**23,077**	0.36%	**25,724**	0.32%
Net Debt	**(21,558)**		**(24,216)**	

The Council during 2017/18 has remained a net investor, despite not undertaking any new borrowing since 2008, for which approval has already been given by the Council in approving the capital programme and prudential indicators.

During the year there remained a significant difference between the cost of borrowing and the investment yields that the Council could secure. The prudential code permits the Council flexibility to bring forward or defer borrowing in relation to its Capital Financing Requirement (i.e. the Council's underlying need to borrow to finance past capital spending). The authority did not undertake any new borrowing in 2017/18 from PWLB. The authority used internal resources to fund capital spending in lieu of borrowing.

5.10 **Borrowings 2017/18**

5.10.1 During 2017/18 the authority did not undertake any new borrowing or debt rescheduling from the PWLB.

5.10.2 The Council's underlying need to borrow is known as the Capital Financing Requirement (CFR). The CFR is a gauge of the Council's debt position. It represents the level of capital expenditure for 2017/18 and earlier years which has not yet been paid for by revenue or other resources.

5.10.3 The CFR is reduced each year by an appropriate revenue charge. This is calculated under the Council's adopted policy, to repay borrowing over the anticipated life of the assets being financed. The total CFR may also be reduced by the application of additional capital resources such as unapplied capital receipts.

5.10.4The Council's CFR for the year is shown below, and represents a key prudential indicator. (Note the approved indicator used an estimated opening position).

Capital Financing Requirement	**31 March 2017 Actual Indicator £000**	**31 March 2018 Budget Indicator £000**	**31 March 2018 Actual Indicator £000**
Opening balance as at 1 April	6,082	5,924	5,925
Add unfinanced capital expenditure	583	2,157	654
Less: Revenue Provision	(740)	(638)	(637)
Closing balance as at 31 March	**5,925**	**7,443**	**5,942**

5.10.5 At 31 March 2018 the Council is £4.4m under-borrowed – this represents the difference between the CFR and actual long term borrowing.

5.10.6 Overall the debt activity during the year resulted in a change in the average interest rate from 4.91% as at 31 March 2017 to 4.93% as at 31 March 2018.

5.11 **Investments 2017/18**

5.11.1 The Council's investment policy is governed by MHCLG guidance which has been incorporated in the annual investment strategy approved by Council on 23 February 2017. The investment activity during the year conformed to the approved strategy, and the Council experienced no liquidity difficulties.

5.11.2 The average investment balance maintained during 2017/18 was £32.4million. It should be stressed that this does not all represent core funds available for investment but also includes short term cash flow balances. The average rate of return on investments was 0.32%. The comparable performance indicator is the average 7 day LIBID rate which was 0.21%.

5.11.3 In the following table the results of the investment strategy undertaken by the Council are shown.

	Average Investment £000	Interest Earned £000	Rate of Return	Benchmark Return *
Bank	2,802	5	0.19%	
Money Market	29,646	99	0.33%	
Overall	32,448	104	0.32%	0.21%

* - the benchmark is taken to be the 7 day LIBID rate (uncompounded) sourced from data provided by Link Asset Services (previously Capita Asset Services), the Council's treasury advisors.

No institutions in which investments were made showed any difficulty in repaying investments and interest in full during the year.

5.11.4 The investments at the 31 March 2018 were

Date	Borrower	Principal	Rate	Due	Accrued Interest	Total
02/01/2018	Nottingham Building Society	1,000,000.00	0.50%	11/04/2018	1,219	1,001,219
03/01/2018	Principality Building Society	4,000,000.00	0.45%	09/04/2018	4,340	4,004,340
08/01/2018	Cumberland Building Society	1,000,000.00	0.55%	18/04/2018	1,251	1,001,251
22/01/2018	Santander UK plc	2,000,000.00	0.48%	23/04/2018	1,815	2,001,815
22/01/2018	Bank of Scotland plc	2,000,000.00	0.50%	23/04/2018	1,890	2,001,890
22/01/2018	Principality Building Society	1,000,000.00	0.43%	23/04/2018	813	1,000,813
30/01/2018	Santander UK plc	1,000,000.00	0.48%	30/04/2018	802	1,000,802
01/02/2018	Santander UK plc	1,000,000.00	0.48%	30/04/2018	776	1,000,776
05/02/2018	Yorkshire Building Society	2,000,000.00	0.40%	30/04/2018	1,205	2,001,205
19/02/2018	Newcastle Building Society	2,000,000.00	0.45%	21/05/2018	1,011	2,001,011
05/03/2018	Nottingham Building Society	1,000,000.00	0.53%	30/05/2018	392	1,000,392
12/03/2018	Nottingham Building Society	3,000,000.00	0.51%	30/05/2018	838	3,000,838
06/09/2017	Bank of Scotland Notice Account	2,000,000.00	0.70%		1,227	2,001,227
	HSBC Call Account	2,705,000.00	0.28%		1,614	2,706,614
		25,705,000			19,193	25,724,193

5.12 Performance Indicators 2017/18

5.12.1 The Code of Practice on Treasury Management requires the Council to set performance indicators to assess the adequacy of the treasury function over the year. These are distinct historic indicators, as opposed to the prudential indicators, which are predominantly forward looking. The following indicators apply to this service:

Debt: Average Rate of Borrowing for the year	2017/18 Actual Rate	2017/18 Average Available Rate
Loan raised in year	**0**	**0**

Debt: Average Rate	31 March 2017	31 March 2018	Movement (+/-)
PWLB Loans **Other Loans**	**5.01%** **0.00%**	**5.01%** **0.00%**	**0%** **0%**

Investments: Average Return	2017/18 Actual Rate	2017/18 7 day LIBID Rate
Internally Managed Funds	**0.32%**	**0.21%**

The Performance Indicators reflect that in a time of historically low interest rates the Council managed to obtain an average interest rate in excess of the benchmark (7 Day LIBID Rate). The priority has been on the security of the investment. As a small Council our investments are often of a small value (i.e. £1 to 2 million) that is not of interest to larger financial institutions. This means that our investments are primarily placed with Building Societies and Money Market Funds for limited periods of time.

5.13 Capital Financing

5.13.1 During 2017/18 the Council complied with its legislative and regulatory requirements. The actual prudential indicators for the year, with comparators, are as follows:

Actual Prudential Indicators	2016/17 Actual £000	2017/18 Budget £000	2017/18 Actual £000
Actual capital expenditure	1,676	8,400	2,853
Capital Financing Requirement	5,925	7,443	5,942
Financing costs as a proportion of net revenue stream	6.26%	10.92%	6.85%

5.13.2 The Council undertakes capital expenditure on long term assets and these activities may be financed immediately through capital receipts, capital grants etc. If, however, insufficient financing is available from these sources, or a decision is taken not to apply capital resources, the expenditure will give rise to a borrowing need.

5.13.3 Part of the Council’s treasury activities is to address this borrowing need, either through borrowing from external bodies, or by utilising temporary cash resources within the Council.

5.13.4 Actual capital expenditure forms one of the required prudential indicators and the following table shows how much was spent and how it was financed.

	2016/17 Actual £000	2017/18 Actual £000
Total capital expenditure	1,676	2,853
Financed by:		
Capital receipts	(439)	(1,177)
Capital grants & contributions	(654)	(1,022)
Revenue	(223)	(84)
Unfinanced capital expenditure (additional need to borrow)	**360**	**570**

5.14 **Other Prudential Indicators**

5.14.1 The Council on the 23 February 2017 approved the Annual Investment Strategy and Prudential Indicators. There is a requirement under the Treasury Management and Prudential Code for these to be reported upon in this annual report.

5.14.2 Some of the required prudential indicators provide either an overview or specific limits on treasury activity. These are shown below.

(a) Net Borrowing and the CFR – in order to ensure that borrowing levels are prudent, over the medium term the Council's external borrowing, net of investments, must only be for a capital purpose. Therefore, borrowing should not exceed the CFR for 2017/18. The table below highlights that the Council has complied with this requirement.

	31 March 2018 Actual Indicator £000	31 March 2018 Approved Indicator £000
Net borrowing position	**(24,216)**	**(16,552)**
Capital Financing Requirement	**5,942**	**7,443**

As the Council is a net investor it has significant headroom in its ability to borrow to meet the Capital Financing Requirement. However, as this report highlights we have not undertaken any new borrowing during 2017/18 from the PWLB.

(b) The Authorised Limit is the "Affordable Borrowing Limit" required by S3 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.

(c) The Operational Boundary is the expected borrowing position of the Council during the year, and periods where the actual position is either below or over the Boundary is acceptable subject to the Authorised Limit not being breached.

The table below compares the Council's maximum and minimum gross borrowing position with the Authorised Limit and Operational Boundary.

	2016/17 Actual £000	2017/18 Original £000	2017/18 Actual £000
Approved Indicator - Authorised Limit	10,000	11,000	11,000
Approved Indicator - Operational Boundary	9,000	9,000	9,000
Maximum gross borrowing position during the year	1,529		1,519
Minimum gross borrowing position during the year	1,519		1,508

5.14.3 Another mandatory indicator shows the ratio of financing costs as a proportion of the net revenue stream. This identifies the trend in the cost of capital (borrowing and other long term obligations net of investment income) against income from government grants, council tax etc. The table compares the actual ratio with the latest approved indicator. This is again impacted upon by the delay in the need to borrow.

	2017/18 Actual Indicator	2017/18 Approved Indicator
General Fund	6.85%	11.03%

5.14.4 Another indicator is the maturity structure of fixed interest rate borrowing.

	2017/18	
	Lower %	Upper %
Under 12 Months	0	10
12 months to 2 years	0	10
2 years to 5 years	0	20
5 years to 10 years	0	30
10 years and above	0	100

6. <u>Legal Issues</u>

6.1 The report fulfils the Council's reporting obligations under the Local Government Act, 2003 and the reporting required through Council adopting the CIPFA code.

6.2 The Council's treasury management activities are regulated by a variety of professional codes and statutes and guidance:

- The Local Government Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;

- The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions were made in 2017/18);

- Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act;

- The SI requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities;

- The SI also requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services;

- Under the Act the MHCLG issued Investment Guidance to structure and regulate the Council's investment activities;

- Under section 238(2) of the Local Government and Public Involvement in Health Act 2007 the Secretary of State has taken powers to issue guidance on accounting practices. Guidance on the approach to Revenue Provision for Loan Repayment was issued under this section on 8 November 2007.

6.3 The Council has complied with all of the relevant statutory and regulatory requirements which limit the levels of risk associated with its treasury management activities. In particular its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach.

7 <u>Resource Issues</u>

7.1 The resource issues are detailed within the report.

8 <u>Equality Implications</u>

8.1 None arising directly from this report.

9 <u>Impact on the Organisation</u>

9.1 The Treasury Management function is an important element of the Council's overall financial affairs. It is inextricably linked to any financial decision which the Council may take, both in revenue and capital terms, and has taken on an even greater importance following the introduction of the Prudential Code.

10 <u>Community Safety Implications</u>

10.1 None arising directly from this report.

11. Carbon Management Implications

11.1 None arising directly from this report.

12. Risk Management Implications

12.1 The report details the treasury and capital decisions in 2017/18 that balanced the security, liquidity and yield risk.

13 Consultation

13.1 The Treasury Policy and Strategy are devised in partnership with the Council's Treasury Consultants, Link Asset Services who can draw on a wide range of economic and market data. Many of the major treasury decisions taken on matters such as premature debt repayment and debt rescheduling are made taking into account advice received from Link Asset Services.

14 Options Considered

14.1 The production of this report to members is a requirement of CIPFA's Code of Practice for Treasury Management in the Public Services, and the Prudential Code.

15 Background Papers

15.1 Final accounts working papers, loans and investment records held by Finance Services.

15.2 CIPFA Treasury Management Code and Guidance Notes.

Previous report(s):

Information Issued Under Sensitive Issue Procedure: N

Ward Members Notified: N

Appendices:

A: Mid Year Treasury Management Report 2018/19