TREASURY MANAGEMENT ANNUAL REPORT 2017/18 AND PRUDENTIAL INDICATORS

Cabinet Member: Councillor D Watson

Wards affected: All

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1. PROPOSED DECISION

The Cabinet is asked to:

1.1. Note the outturn position for treasury management activities for 2017/18; and

1.2. Refer this report to the Audit Committee for review.

2. Corporate implications

2.1. The Council meets the requirements of the CIPFA Code of Practice for Treasury Management and Prudential Code for Capital Finance in Local Authorities.

2.2. As part of the Code the Council approved the Treasury Management Strategy for 2017/18 along with a series of prudential indicators and measure its performance against them. These indicators and performance are detailed within the main body of the report.

2.3. In accordance with Central Government Guidance on Local Government Investments, and the CIPFA Treasury Management Code of Practice, the order of the Council's investment priorities is 1. Security; 2. Liquidity; and, 3. Return. This may result in the Council achieving a lower rate of return than an organisation operating a more aggressive investment strategy in a less regulated sector.

3. Regulatory Background

3.1. The Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2017/18. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management, (the Code), and the CIPFA Prudential Code for Capital Finance in Local Authorities, (the Prudential Code).

3.2. 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 23rd February 2017.
- A mid-year (minimum) treasury update report Audit Committee 16th November 2017.
- An annual review following the end of the year describing the activity compared to the strategy (this report).

3.3. 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.

3.4. 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 Committee before they were reported to the full Council.

3.5. The Treasury Management Annual Report covers three main areas summarised below:

Capital activity (section 5)

- Capital expenditure and funding;
- Capital Financing Requirements (CFR); and
- Affordability Indicators

Borrowing (section 6)
Treasury (section 7)

- Overall treasury position; and
- Summary of Interest Rates.

4. The Economy and Interest rates

4.1. The Council receives independent external advice from Link Asset Services as professional financial advisers. The independent view of the external adviser on the macro-economic environment facing the Council and the interest rate risks is attached at Appendix A.

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

5.1. The Council undertakes capital expenditure on long-term assets. These can be financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.) or if insufficient financing is available from those sources or a decision is taken not to use those resources, the expenditure will give rise to a borrowing need.

5.2. The capital expenditure statement forms one of the required prudential indicators. The table below shows how capital expenditure was financed:

2016/17 £m	Capital Expenditure and Funding	2017/18 £m
14.017	**Capital Expenditure**	**11.785**
	Funding	
-4.900	Capital Receipt	-6.739
-2.213	Capital Grants and Contributions	-5.046
-6.904	Revenue	0.000
-14.017	**Total Funding**	**-11.785**

Capital Financing Requirements

5.2.1. The Council's underlying need to borrow for Capital Expenditure is called the Capital Financing Requirement (CFR). It represents the cumulative 2017/18 and previous years' net capital expenditure which has not yet been funded by revenue or other resources, but has been paid for by borrowing either externally or by borrowing from internal existing cash balances.

5.2.2. The CFR is reduced each year by a statutory revenue charge called the Minimum Revenue Provision (MRP). This CFR can also be reduced by the application of additional capital resources such as capital receipts or charging more than the statutory revenue charge (MRP), through a Voluntary Revenue Provision (VRP).

5.2.3. The MRP policy is required to be approved by Council annually and this was approved for 2017/18 on 23rd February 2017 by Council.

5.2.4. The Council's CFR for the year is shown below, and represents a key prudential indicator. It includes the waste contract embedded lease for vehicles and bins on the balance sheet, which increase the Council's borrowing need. No borrowing is actually required against these schemes as a borrowing facility is included within the contract.

2016/17 £m	Capital Financing Requirement (CFR)	2017/18 £m
8.188	**CFR as at 1 April**	**6.862**
-1.326	Minimum Revenue Provision	-0.992
6.862	**CFR as at 31 March**	**5.870**

5.3. **Affordability** - 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. This financing costs excludes revenue funding (purchase of Sword House).

2016/17	Table 3	2017/18
Actual		Forecast
4.58%	Ratio of financing cost	3.44%
0.00	No additional Borrowing, therefore Incremental Impact on Council Tax is '0'	0.00

6. Borrowing

6.1. **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. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator as detailed in the table on the next page.

2016/17 £m	Borrowing V CFR	2017/18 £m
3.206	Gross Projected Debt	2.390
6.862	CFR 31st March	5.870
3.656	**Under borrowing**	**3.480**

6.1. **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.

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

2016/17	Authorised Limit & Operational	2017/18 set Limits	2017/18 Actual
£m	**Boundary for External Debt**	**£m**	**£m**
	Authorised Limit for external debt		
3.206	Borrowing and other long term liabilities	19.000	2.390
	Operational Boundary for external debt		
3.206	Other long term liabilities (Finance Lease)	18.000	2.390
3.206	**Total**	18.000	2.390

7. Treasury Position and Interest Rates

Treasury Position

7.1. The Council's investment policy, approved by Council in February 2017, sets out the approach for choosing investment counterparties. It is based on a system of credit ratings provided by the three main credit rating agencies, and supplemented by additional market data (such as rating outlooks, credit default swaps and bank share prices) provided by Link Asset Services, the Council's treasury advisors.

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

7.3. The Council on 9th October 2017 approved the use of property investments, direct and indirect, to achieve improvements in Treasury Yields, up to a maximum investment value of £15.000m. The Council invested £7.500m in the CCLA Property Fund on 1st December 2017. The net yield for the CCLA Local Authorities Property Fund for the period December 2017 to March 2018 is 4.23%.

7.4. The Council's 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 through member reporting. As at 31 March 2018, the Council did not have any external borrowing and the treasury investments were £80.03m earning an average rate of return at 0.73%. The Treasury position is summarised in the table below.

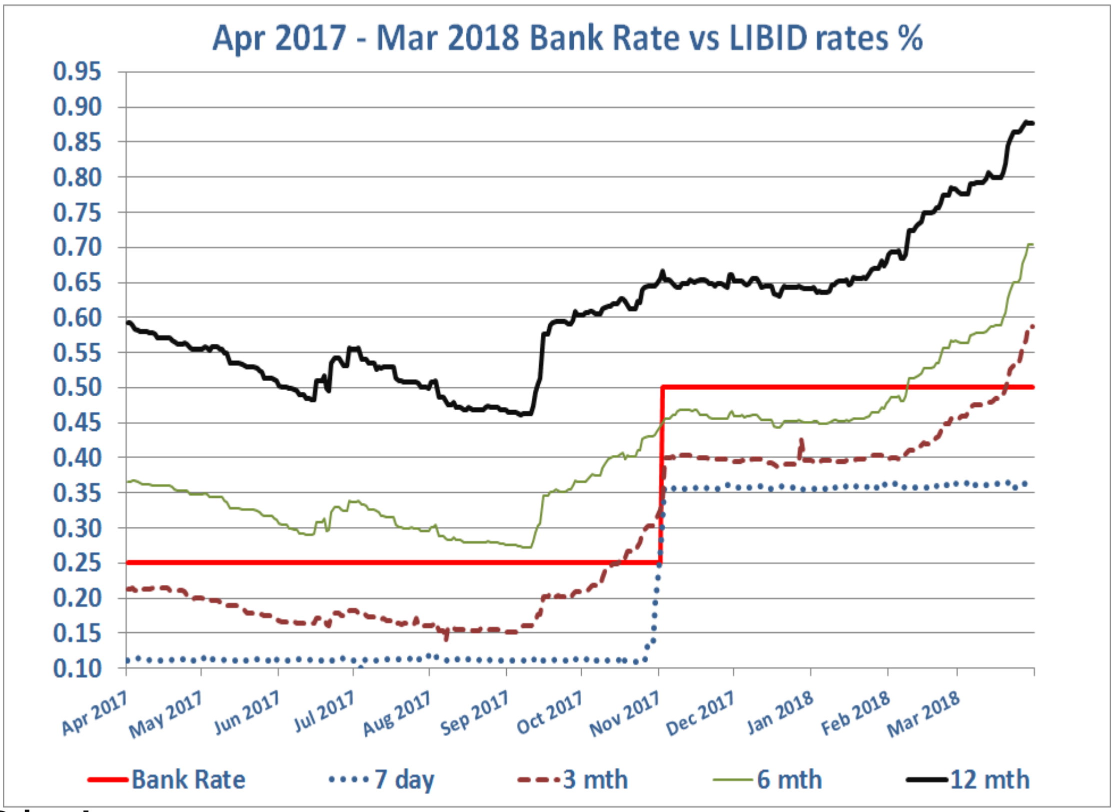
As at March 2017			As at March 2018	
£m	%		£m	%
		Specified Investments (up to 1 year)		
32.60	43%	Banks & Building Socities	39.55	49%
9.00	12%	Local Authorities	0.000	0%
22.00	30%	Money Market Funds	15.00	19%
		Non-Specified Investments (longer than 1 year)		
6.00	8%	Banks & Building Socities	0.00	0%
0.00	0%	Local Authorities	13.00	16%
5.00	7%	Gilt	4.98	6%
0.00	0.00	Property Fund	7.50	9%
74.60	**100%**	**Total Funding**	**80.03**	**100%**

7.5. The Council held £80.03m of investments as at 31 March 2018 compared with £74.627m at 31 March 2017. The investment portfolio yield for financial year is 0.73% against the 7 day London Interbank Bid Rate (LIBID) of 0.21%.

7.6. On two occasions the Council exceeded its £4m limit with its own banking services provider Natwest Plc. The excess balance position arose due to unexpected cash being received late in the day and treasury staff not being able to place the funds in another suitable counterparty due to the financial markets being closed. On these occasions investments with Natwest Plc were brought within the approved limit at the first available opportunity. Aside from the two occasions the Council has complied with its approved investment strategy.

Interest Rates

7.7. 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 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. The graph on the next page compares the Bank Rate to LIBID rates for the period April 2017 to March 2018.



8. Other Issues

8.1. Revised CIPFA Codes

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. Officers will report to members when the implications of these new codes have been assessed as to the likely impact on this Authority.

8.2. 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.

Background papers:

1. Treasury Management strategy 2017/18 approved by the Council on 23rd February 2017.
2. CIPFA Code of Practice on Treasury Management
3. CIPFA Prudential Code for Capital Finance in Local Authorities