Meeting:	**EXECUTIVE / AUDIT COMMITTEE / COUNCIL**	**Agenda Item:**
Portfolio Area:	Resources	
Date:	**5 September / 12 September / 17 October**	

ANNUAL TREASURY MANAGEMENT REVIEW OF 2017/18 INCLUDING PRUDENTIAL CODE

NON-KEY DECISION

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1 PURPOSE

1.1 To review the operation of the 2017/18 Treasury Management and Investment Strategy.

2 RECOMMENDATIONS

2.1 **Audit Committee & Executive**
That subject to any comments the 2017/18 Annual Treasury Management Review is recommended to Council for approval.

2.2 **Council**
That subject to any comments from the Audit Committee and the Executive, the 2017/18 Annual Treasury Management Review be approved.

3 BACKGROUND

3.1 Regulatory requirement

3.1.1 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).

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

- an annual treasury strategy in advance of the year (Council 28/02/2017)
- a mid-year treasury update report (Council 14/12/2017)
- an annual review following the end of the year describing the activity compared to the strategy (this report).

3.1.3 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.

3.1.4 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 and the Executive before they were reported to the Council.

3.2 **The Economy and Interest rates in 2017/18**

3.2.1 During the calendar year of 2017, there was a major shift in expectations in financial markets in terms of how soon Bank Rate would rise. The UK economy showed growth in the second half of 2016 but growth in 2017 was weaker in the first half of the year, 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 service 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 MPC would be heading in the direction of a Bank Rate rise. At the 2 November MPC quarterly Inflation Report meeting Bank Rate was raised 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. Subsequently bank rates have risen again to 0.75% on 2 August 2018.

3.2.2 **PWLB borrowing rates** increased correspondingly to the above developments with the shorter term rates increasing more sharply than longer term rates. 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 the latest three increases was greater in shorter terms of around 5 years, rather than longer term yields.

The major UK landmark event of the year was the **general election** on 8 June. However, this had relatively little impact on financial markets.

4 OVERALL TREASURY POSITION AS AT 31 MARCH 2018

4.1 At the beginning and the end of 2017/18 the Council's treasury position was as follows:

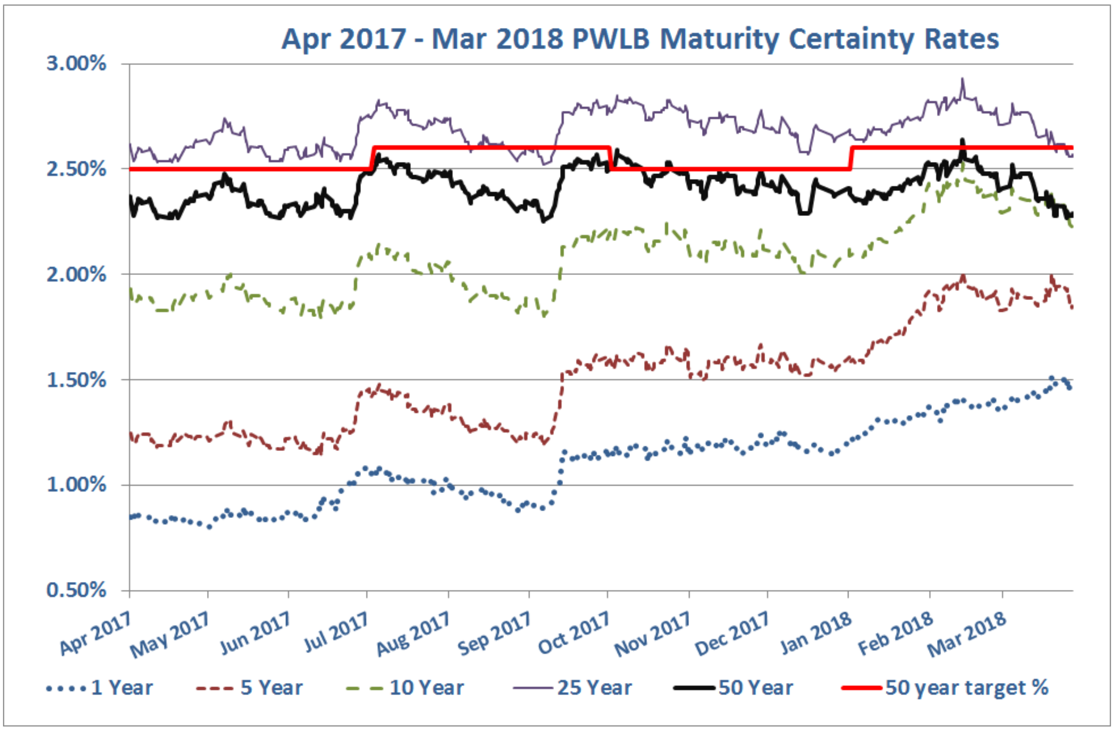
Table One: Treasury Position						
	2016/17			2017/18		
	31 March 2017 Principal £'000s	Rate / Return %	Average Life (Yrs)	31 March 2018 Principal £'000s	Rate / Return %	Average Life (Yrs)
Total Borrowing	**209,494**	**3.38**	**16.66**	**208,487**	**3.38**	**15.81**
Capital Financing Requirement	223,275			221,877		
Over/(under) borrowing	(13,781)			(13,390)		
Investments Portfolio	**57,595**	**0.57**		**62,380**	**0.58**	

5 TREASURY MANAGEMENT STRATEGY 2017/18

5.1 The original 2017/18 Treasury Management strategy had projected low but rising Bank Rate starting from 2nd quarter of 2019 and gradual rises in medium and longer term fixed borrowing rates during 2017/18.

5.2 During 2017/18 base rates remained low and consequently yields were low compounded by counterparty risk considerations. There continued to be a gap between investing (0.58%) and borrowing rates (2.9% - 25yr PWLB rate March 2018) which meant it was still prudent to maintain the treasury strategy of postponing external borrowing. This policy avoids the cost of holding higher levels of investments and reduces counterparty risk, by using internal borrowing while cash balances allow. (See also section 5.7).

5.3 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 graph below shows how PWLB 25 and 50 year rates have been volatile during the year and shorter rates were on the rising trend during the second half of 2017/18 and reached peaks in February/March.



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

5.4.1 In 2017/18 the Council spent £26,036,000 on capital projects (General Fund and Housing Revenue Account). The total capital programme was funded from existing capital resources and new prudential borrowing. The borrowing of £1,755,950 was taken for the acquisition of Commercial Property Portfolio as approved by the Council on 17 May 2017. No other external loans were taken out during 2017/18 to fund existing borrowing requirements from previous years. Table two details capital expenditure and financing used in 2017/18.

Table two : 2017/18 Capital Expenditure and Financing				
	2017/18 Original Estimate £'000	2017/18 Quarter 3 Revised Working Budget £'000	2017/18 Actual £'000	2017/18 Variance Actual to Quarter 3 Revised Working Budget £'000
Capital Expenditure:				
General Fund Capital Expenditure	7,799	20,663	9,013	(11,650)*
HRA Capital Expenditure	16,335	17,525	17,022	(503)
Total Capital Expenditure	**24,134**	**38,188**	**26,036**	**(12,153)**
Resources Available for Capital Expenditure:				
Capital Receipts	(8,111)	(14,951)	(14,797)	154
Capital Grants /Contributions	(375)	(3,416)	(738)	2,678
Capital Reserves	(1,981)	(2,695)	(1,716)	979
Revenue contributions	(114)	(114)	(89)	25
Major Repairs Reserve	(9,683)	(3,813)	(6,940)	(3,127)
Total Resources Available	**(20,263)**	**(24,988)**	**(24,280)**	**709**
Capital Expenditure Requiring Borrowing	**3,870**	**13,200**	**1,756**	**(11,444)**

* £11,650,000 relates to slippage of commercial property portfolio and site assembly as detailed in Q4 outturn report to Members on 11th July 2018.

5.4.2 The Treasury Management review of 2017/18 and Prudential Indicators have been updated to reflect changes to capital budgets which have been approved throughout the year. The actual capital expenditure for 2017/18 has already been reported to Executive on 11 July 2018.

5.5 **The Council's overall need to borrow and Capital Financing Requirement**

5.5.1 The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR). It represents the amount of debt it needs to/has taken out to fund the programme (and includes both internal and external borrowing). The CFR is then reduced as debt repayments are made and Minimum Revenue Provisions (MRP – see also para 5.6) are made. A separate CFR is calculated for the General Fund and Housing Revenue Account and any transfers of assets (such as land or buildings) will impact on each fund's CFR. The CFR will go up on the fund "receiving" the assets and go down (by the same amount) on the fund "giving" the asset.

5.5.2 Cash balances (£62.38M as at 31 March 2018) enable the Council to use internal borrowing in line with its Capital Strategy and Treasury Management

Strategy. This position is kept under review taking into account future cash balances and forecast borrowing rates. Members should note that these cash balances relate in part to the restricted use right to buy “one for one” receipts (£10.1million) and provisions (£10.3million) for future liabilities (see also para 5.7.4).

5.5.3 As at the 31 March 2018 the Council had total external borrowing of £208,486,739. The debt repayment profile is shown in the following table:

Table Three Maturity of Debt Portfolio for 2016/17 and 2017/18		
Time to maturity	**31 March 2017 Actual £'000's**	**31 March 2018 Actual £'000's**
Maturing within one year	4,004	3,004
1 year or more and less than 2 years	1,763	263
2 years or more and less than 5 years	789	790
5 years or more and less than 10 years	8,763	18,956
10 years or more	194,175	185,474
Total	**209,494**	**208,487**

5.5.4 The General Fund had external borrowing of £4,571,739, of which £1,500,000 was with a local authority and the remainder with the Public Works Loan Board (PWLB). The HRA had external borrowing of £203,915,000 all held with the PWLB, of which £9,004,000 relates to pre 2012 decent homes programme and the remainder £194,911,000 to self- finance the payment made to central government in 2012.

5.5.5 The HRA borrowing is constrained by legislation and is capped at £217,685,000. As at the 31 March 2018 the head room available for new HRA borrowing was £11,431,577.

5.5.6 The Council’s CFR is one of the key prudential indicators and is shown in the following table.

Table Four : Capital Financing Requirement 2016/17 and 2017/18			
CFR Calculation	**31-Mar-17 (£'000)**	**31-Mar-18 (£'000)**	**Movement in Year (£'000)**
Opening Balance	**223,929**	**223,275**	
Closing Capital Financing Requirement (General Fund)	14,769	15,623	854
Closing Capital Financing Requirement (Housing Revenue Account)	208,506	206,253	(2,253)
Closing Balance	**223,275**	**221,877**	
Increase/ (Decrease)	**(654)**	**(1,399)**	**(1,399)**

5.5.7 The CFR for the HRA is reduced by £2,252,500 as a repayment of £2,500,000 was made in year and 29 Shephall Way was transferred between the General Fund and HRA for £247,500.In 2018/19 there is a scheduled debt repayment of £1,241,000, further borrowing of £3,500,000 originally forecasted (approved as part of the updated HRA business plan) was not taken in 2017/18.

5.5.8 The General Fund's CFR has increased by £854,078 - due to;

- new borrowing taken for Commercial Property Portfolio of £1,755,950,
- the Minimum Revenue Provision (MRP) made in year of £654,372 and
- Shephall Way transferred between the General Fund and HRA

5.5.9 In 2018/19 there is a scheduled debt repayment of £1,500,000 borrowed from a local authority. Further borrowing of £13,244,000 (already approved by the Council) was not taken in 2017/18.

5.6 Minimum Revenue Provision (MRP)

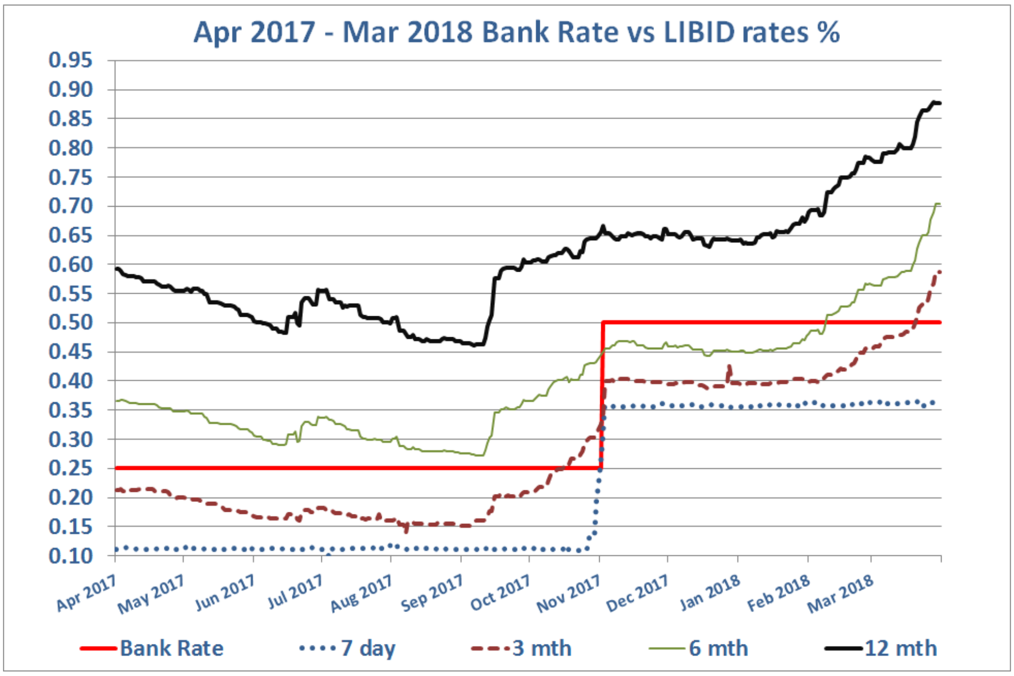
5.6.1 The Prudential Code, by which the Council has to make its borrowing decisions, requires the Council to demonstrate that borrowing is required and affordable. The MRP is a statutory requirement to ensure borrowing is affordable for the General Fund and does not apply to the HRA (the HRA affordability has been determined by central government in setting the HRA's debt cap (see also para 5.5.5)). The Council is required to make an annual MRP based on its policy approved by Council as part of the Treasury Management Strategy. The calculation of MRP is based upon prior years' borrowing requirement (regardless of whether that borrowing was internal or external) and the life of the asset for which the borrowing was required.

5.6.2 The MRP charged to the General Fund in 2017/18 was £654,371.

5.7 **Cash Balances and Investment rates**

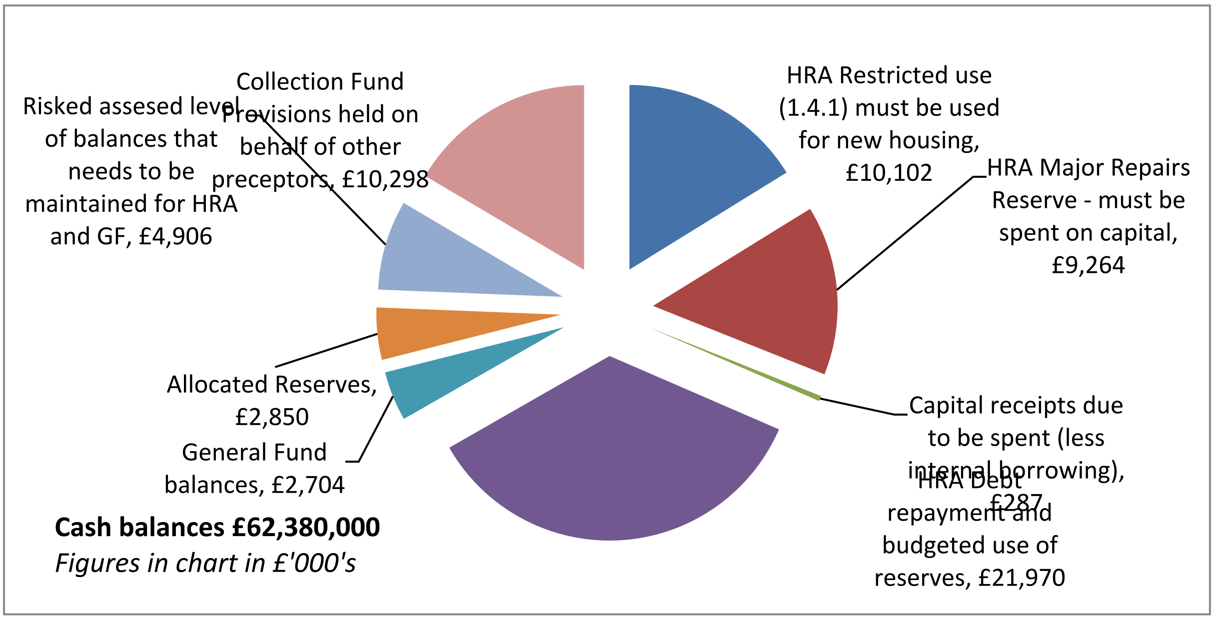
5.7.1 As at 31 March 2018 cash balances held by the Council were £62.380Million. During the year the average cash balance was £72Million, earning interest of £416,436 and achieving an average interest rate of 0.58%. The comparable rate was 0.21% (average 7-day LIBID rate). This compares with an original budget assumption of £207,810 based on average investment rate of 0.42% however higher cash balances and better than anticipated rates resulted in more investment interest. No funds were placed with the Debt Management Office (DMO) during 2017/18.

5.7.2 Investments rates for 3 months and longer had 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 November 2017 and remained at that level for the rest of the year. However, further increases are expected over the next few years (4th August 2018 was raised to 0.75%). Deposit rates continued into the start of 2017/18 at previous low 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 February 2018. The following chart shows Bank rate and LIBID rates in 2017/18.

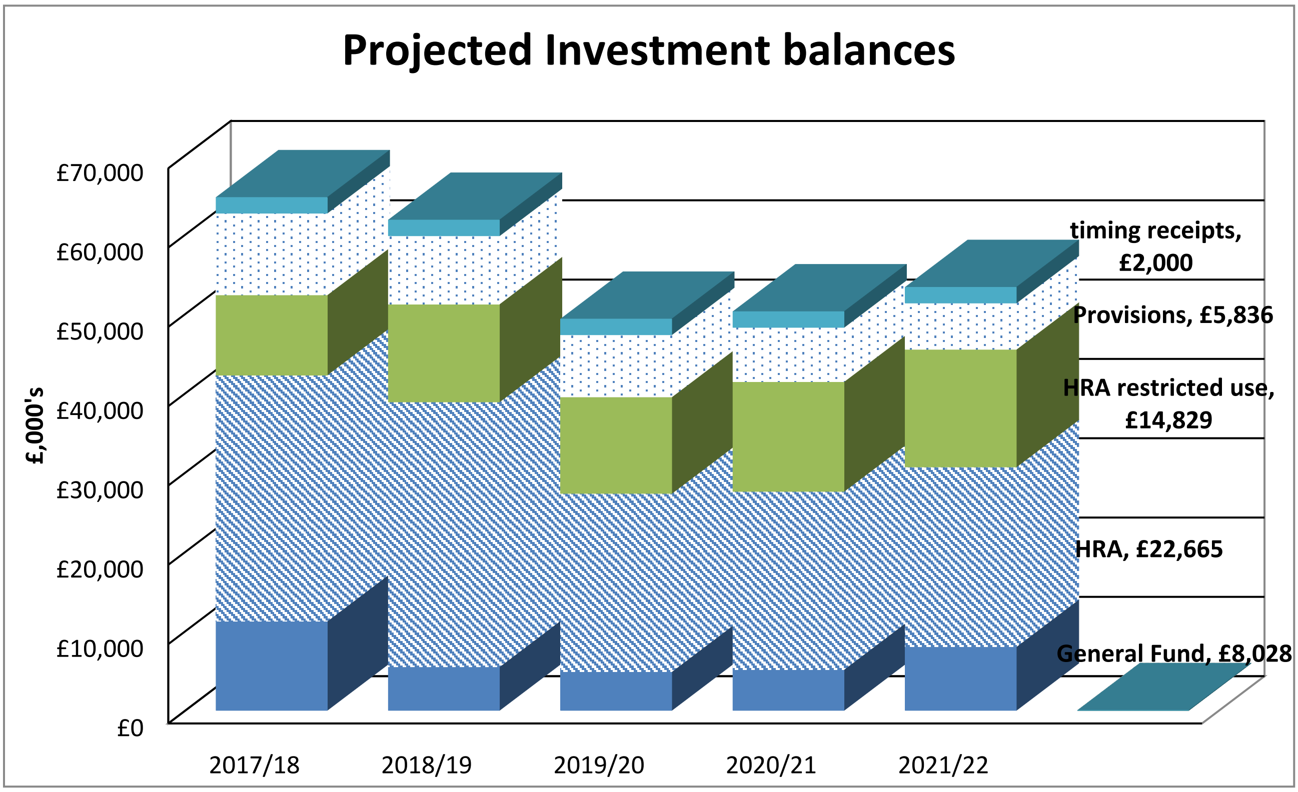


5.7.3 Cash balances were £62.38million at the end of the year partly due to retention of one for one right to buy receipts ring fenced for HRA new social housing schemes (£10.1Million), provisions and reserves held for specific purposes. The restrictive use of a proportion of these receipts plus the planned use of resources in line with the Council’s capital and revenue strategies means that these resources are not available for new expenditure.

The following pie chart details the resources held in cash balances and type of expenditure they can be used for.



5.7.4 The following chart shows the historic level of cash balances and the current projections to 2020/21.



5.7.5 The Council invests it surplus cash balances in accordance with the Treasury Management Strategy approved by Council on 28 February 2017. The 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 and counterparty limits dependant on level of cash balances held.

5.7.6 There were no breaches to this policy in 2017/18 with the investment activity during the year conforming to the approved strategy and the Council had no liquidity difficulties.

5.8 **Other Prudential Indicators**

5.8.1 The treasury management indicators for 2018/19 onwards have been updated based on the updated Capital Strategy approved by Council in February 2018 and subsequently updated in the 3rd and 4th quarter capital updates reported to Executive and Council in March and July 2018.

5.8.2 The **net borrowing position** for the Council as at 31 March 2018 was **£146.107Million** (total borrowings/loans of £208.487Million less total investments held of £62.380Million).

5.8.3 The operational boundary and authorised limit refers to the borrowing limits within which the treasury team operate. A temporary breach of the operational boundary is permissible for short term cash flow purposes however a breach of the authorised limit would require a report to Council. **There were no breaches of either limit in 2017/18.**

5.8.4 The **ratio of financing costs** to net revenue stream is equal to General Fund interest costs divided by the General Fund net revenue income from Council tax, Revenue Support Grant and retained business rates. The 2017/18 indicator is 6.91%.

5.8.5 The full list of treasury prudential indicators is shown in Appendix A and has been updated for the 2017/18 outturn position and the revised 2018/19 capital programme.

5.8.6 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. According to the changes to the Code, the following Prudential Indicators are no longer a requirement, therefore they have been removed from Appendix A (Prudential Indicators).

- Incremental impact of capital investment decisions
- Upper Limit for fixed interest rate exposure
- Upper Limit for variable interest rate exposure and
- Upper limit for total principal sums invested for over 364 days

6 OTHER ISSUES

6.1 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. The revised code included a distinction between treasury and non-treasury (eg property investments) types of investment. Officer propose to meet the requirement of the new code by incorporating additional information into the Capital and Revenue budget setting reports (2019/20 onwards) to Executive and Council to enable Members to see how the cash resources of the Authority have been apportioned between treasury and non-treasury investments.

6.2.1 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. The Council fulfilled the requirements of professional status and subsequently the MiFID II has had little impact on the Council's Treasury Management activities.

6.2.2 Breach of overdraft Limit on 21 May 2018

On 21 May 2018, a request was made to return funds held by the Council from Amundi, a Money Market Fund (MMF). This fund is held in a Luxembourg bank. Council staff was unaware that it was a bank holiday on that day in Luxembourg, where Amundi's bank is based, which meant that the requested was not processed and funds weren't returned until the next working day. A short term overdraft facility was arranged to ensure Council's obligations were met, which resulted in an interest payment of £3,006.20. All Non-UK Bank holidays are now noted in the daily cash sheet, in addition to a pop up message on the portal that will alert staff in future.

7 IMPLICATIONS

7.1 Financial Implications

7.1.1 This report is of a financial nature and reviews the treasury management function for 2017/18. Any consequential financial impacts identified in the July Capital strategy and 4th quarter revenue budget monitoring report have been incorporated into this report.

7.1.2 During the financial year Officers operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices.

7.2 Legal Implications

7.2.1 Approval of the Prudential Code Indicators and the Treasury Management Strategy are intended to ensure that the Council complies with relevant legislation and best practice.

7.3 Equalities and Diversity Implications

7.3.1 The purpose of this report is to review the implementation of the Treasury management policy in 2017/18. Before investments are placed with counter parties the Council has the discretion not to invest with counter parties where there are concerns over sovereign nations' human rights issues.

7.3.2 The Treasury Management Policy does not have the potential to discriminate against people on grounds of age; disability; gender; ethnicity; sexual orientation; religion/belief; or by way of financial exclusion. As such a detailed Equality Impact Assessment has not been undertaken.

7.4 Risk Implications

7.4.1 The current policy of not borrowing externally only remains financially viable while cash balances are high and the differentials between investment income and borrowing rates remain. Should these conditions change the Council may need to borrow at higher rates which would increase revenue costs.

7.5 Policy Implications

7.5.1 This report confirms treasury decisions have been made in accordance with the policy.

BACKGROUND PAPERS

- BD1 Mid year Treasury update (Council 14 December 2017)
- BD2 Treasury Management Strategy including Prudential Code Indicators 2017/18 (Council 28 February 2017)

APPENDICES

- Appendix A Prudential Indicators
- Appendix B Investment and Borrowing Portfolio.