Allerdale Borough Council

Audit Committee – 27 July 2018
Council – 19 September 2018

Treasury Management Annual Review 2017/18

The Reason for the Decision	To inform members of the performance of the Council's treasury management (TM) activities during 2017/18, the effects of TM decisions and transactions executed in the past year and of compliance with its Treasury Management Policy.
Recommendations	That the contents of this report be noted.
Financial / Resource Implications	None
Legal / Governance Implications	The CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code) requires the Council to report on specific aspects of its treasury management activities after the year end.
Community Safety Implications	None
Health and Safety and Risk Management Implications	The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured.
Equality Duty considered / Impact Assessment completed	N/A
Wards Affected	None directly
The contribution this decision would make to the Council's priorities	None directly
Is this a Key Decision	No
Portfolio Holder	Councillor B. Cannon

Lead Officer	Barry Lennox, Financial Services Manager Ext: 2586 email: barry.lennox@allerdale.gov.uk

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Report Implications

Community Safety	N	Employment (external to the Council)	N
Financial	N	Employment (internal)	N
Legal	Y	Partnership	N
Social Inclusion	N	Asset Management	N
Equality Duty	N	Health and Safety	N

1.0 **Introduction**

1.1 Regulations issued under the Local Government Act 2003 require the Council to produce an annual report on its treasury management activities and prudential and treasury indicators for the financial year. This report satisfies this obligation and the associated reporting requirements of the CIPFA Code of Practice on Treasury Management (the TM Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

1.2 During 2017/18 the minimum reporting requirements - set out in the Council's Treasury Management Strategy Statement (TMSS) and Investment Strategy - were that Council should receive the following reports:

- an annual Treasury Management Strategy Statement and Investment Strategy in advance of the year (Council 1 March 2017)
- a mid-year treasury update report (Council 17 January 2018)
- an annual review following the end of the year describing the activity compared to the strategy (this report).

1.3 The regulatory environment places responsibility on members for the review and scrutiny of the Council's treasury management policies and activities. This report is important in that respect, as it provides:

- details of the Council's treasury activities during the financial year and its overall treasury position at 31 March 2018
- evidence of compliance with the treasury policies previously approved by members.

1.4 To enable the Audit Committee to fulfil its responsibilities for ensuring effective scrutiny of the treasury management strategy and policies, the Council's Treasury Management Practices (TMPs) require treasury management reports - including the annual report - to be submitted to the Audit Committee prior to their consideration by Council.

1.5 This report summarises the following:-

- The economy and interest rates (section 2)
- Overall treasury position at 31 March 2018 (section 3)
- The strategy for 2017/18 (section 4)
- Borrowing requirement (section 5)
- Borrowing rates (section 6)
- Borrowing activity during 2017/18 (section 7)
- Investment rates (section 8)
- Investment outturn for 2017/18 (section 9)
- Prudential and Treasury Indicators (section 10 and Appendix A).
- Other matters arising during 2017/18 (section 11)

2.0 The Economy and Interest Rates

U.K.

2.1 The outcome of the EU referendum in June 2016 resulted in a pessimistic economic outlook and forecasts from the Bank of England based around an expectation of a major slowdown in UK GDP growth, particularly during the second half of 2016, which was expected to push back the first increase in Bank Rate for at least three years.

2.2 The Bank responded in August 2016 by cutting the Bank Rate by 25 basis points (0.25%) and making available over £100bn of cheap financing to the banking sector up to February 2018 (the Term Funding Scheme). Both measures, alongside an expansion of the Banks Quantitative Easing (QE) programme, were intended to stimulate growth in the economy and counter the expected downturn in economic growth following the EU referendum. However this gloom was overdone as the UK economy turned in a G7 leading growth rate of 1.8% in 2016, (joint equal with Germany) and followed it up with another 1.8% in 2017, (although this was a comparatively weak result compared to the US and Euro-Zone (EZ)).

2.3 During the 2017 calendar year there was a major shift in expectations in financial markets in terms of how soon the Bank Rate would start on a rising trend. After the UK economy had 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. Estimates included in the Quarterly National accounts issued in March showed growth in quarter 1 of +0.3% (+1.7% y/y) and quarter 2 growth of +0.3% (+1.5% y/y), which meant that growth in the first half of 2017 was the slowest for the first half of any year since 2012.

2.4 The main reason for this slowdown was a weakening of consumption triggered by the sharp increase in inflation caused by the fall in the value of sterling after the EU referendum, feeding increases into the cost of imports into the economy. This in turn caused a reduction in consumer disposable income and spending power as inflation exceeded average wage increases. As a consequence, the services sector of the economy, which accounts for around

75% of UK GDP, saw weak growth as consumers responded by cutting back on their expenditure.

2.5 Market expectations, that the MPC would be heading in the direction of imminently raising Bank Rate rose significantly during the autumn. While the Bank of England is expected to give forward guidance to prepare finance markets for gradual changes in policy, the Banks Monetary Policy Committee (MPC) meeting minutes of 14 September 2017 surprised markets and forecasters by suddenly switching to a more aggressive tone in its words, warning that the Bank Rate would need to rise shortly. The Bank's November quarterly Inflation Report meeting duly delivered on this warning by withdrawing the 0.25% emergency rate cut which had been implemented in August 2016. Market debate then moved on to whether this would be a one and done move for maybe a year or more by the MPC, or the first of a series of increases in Bank Rate over the next two to three years.

2.6 The Bank's forward guidance of two more increases of 0.25% by 2020 was viewed as being more dovish than markets had expected, i.e. there was now little pressure to raise rates by much over that time period. In particular, the GDP growth forecasts were pessimistically weak, while there was little evidence of building pressure on wage increases despite remarkably low unemployment.

2.7 In September the MPC forecast CPI to peak at about 3.1% in November but chose to tolerate this breach of its 2% target on the grounds that this was a one-off result of the steep fall in the value of sterling following the result of the EU referendum. The inflation forecast showed the MPC expected inflation to come down to near the 2% target over the two to three year time horizon. This all seemed to add up to cooling expectations of much further action to raise Bank Rate over the next two years.

2.8 However, GDP growth in the second-half of 2017 came in stronger than expected, while in the new-year there was evidence that wage increases had started to rise. In quarter 3 of 2017, GDP growth picked up to 0.5% before dipping slightly to 0.4% in quarter 4, giving an annual growth figure for 2017 of 1.8%, the same as the upwardly revised figure for 2016. The 8 February MPC meeting minutes consequently revealed another sharp hardening in MPC warnings of a more imminent and faster pace of increase in the Bank Rate than had previously been indicated to the markets. Nevertheless, while there remains so much uncertainty around the Brexit negotiations, consumer spending levels and business investment, it is still far too early to be confident about how strong growth and inflationary pressures will be over the next two years and therefore, the pace of any rate increases.

2.9 The primary reason why the MPC has become more aggressive with its wording around the pace of increases in Bank Rate in, and since September, is due to an emerging view that with unemployment falling to 4.2% (in Jan to March 2018), the lowest level since 1975, and improvements in productivity being so weak, the amount of spare capacity in the economy has also significantly diminished. In particular, the MPC has been concerned at building pressure on rising average wage rates. The Bank has also shifted its focus towards bringing inflation down to 2% over a more conventional 18 to 24 month period (rather than a two to three year timeframe).

2.10 Inflation was on an upward path for much of 2017 and peaked at 3.1% in November, consistent with MPC's forecast. Although CPI inflation ended the year at 2.5%, the February 2018 MPC forecast still sees CPI above its target rate of 2% in two years' time. This resulted in a marked increase in expectations of another Bank Rate increase in May 2018 and an acceleration of the timing of subsequent increases in Bank Rate. This shift in market expectations resulted in investment rates from 3 to 12 months increasing sharply during the spring quarter. However, weak economic data for quarter 1 of 2018 saw the MPC leave rates unchanged in May.

2.11 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.

2.12 As for equity markets, the FTSE 100 hit a new peak near to 7,800 in early January. This was followed by a sharp selloff in a number of stages during the spring, replicating similar developments in US equity markets.

2.13 The major UK landmark event of the year was the inconclusive result of the general election on 8 June. This had relatively little impact on financial markets. However, sterling did suffer a sharp fall against most other currencies, although it has recovered about half of that fall since then. Brexit negotiations have been a focus of much attention and concern during the year but so far, although there has been progress, this has been slow and insufficient to allay market concerns.

2.14 The manufacturing sector has been the bright spot in the economy, seeing stronger growth, particularly as a result of increased demand for exports. It has helped that growth in the EU, our main trading partner, has improved significantly over the last year. However, the manufacturing sector only accounts for around 11% of GDP so expansion in this sector has a much more muted effect on the average total GDP growth figure for the UK economy as a whole.

European Union

2.15 Economic growth in the EU, (the UK's biggest trading partner), was lack lustre for several years after the financial crisis. This is despite the ECB cutting its main rate to -0.4% and embarking on a massive programme of quantitative easing to stimulate growth. However, growth did eventually pick up in 2016 and subsequently gathered further momentum to produce an overall GDP figure for 2017 of 2.3%. Nevertheless, despite providing this massive monetary stimulus, the ECB is still struggling to get inflation up to its 2% target and in

March, inflation was still only 1.4%. It is, therefore, unlikely to start an upswing in rates until possibly towards the end of 2019.

U.S.

2.16 Growth in the American economy was volatile in 2015 and 2016. 2017 followed a similar path with quarter 1 at 1.2%, quarter 2 at 3.1%, quarter 3 at 3.2% and quarter 4 at 2.9%. The annual rate of GDP growth for 2017 was 2.3%, up from 1.6% in 2016. Unemployment in the US also fell to the lowest level for 17 years, reaching 4.1% in October to February, while wage inflation pressures and inflationary pressures in general, have been building.

2.17 The Federal Reserve (the Fed) has been the first major western central bank to start on an upswing in rates with six increases since the first one in December 2015 to lift the central rate to 1.50% to 1.75% in March 2018. There could be a further two or three increases in 2018 as the Fed faces a challenging situation with GDP growth trending upwards at a time when the recent Trump fiscal stimulus is likely to increase growth further. This is likely to increase inflationary pressures in an economy which is already operating at near full capacity. In October 2017, the Fed also became the first major western central bank to make a start on unwinding quantitative easing by phasing in a gradual reduction in reinvesting maturing debt.

Asia

2.18 Chinese economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus. Medium term risks are also increasing especially as a result of credit intensive growth. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems.

2.19 GDP growth in Japan has been improving to reach an annual figure of 2.1% in quarter 4 of 2017. However, it is still struggling to get inflation up to its target rate of 2% despite huge monetary and fiscal stimulus, although inflation has risen in 2018 to reach 1.5% in February. It is also making little progress on fundamental reform of the economy.

3.0 Overall Treasury Position at 31 March 2018

3.1 The Council's treasury position at the beginning and end of 2017/18 was as follows:

Table 1: Overall treasury position

	31.3.17 Principal £'000	Rate/ Return[1] %	Av. Life Years	31.3.18 Principal £'000	Rate/ Return[1] %	Av. Life Years
PWLB loans	13,607	5.85	27	15,380	5.42	25
Other borrowing	85	0.00	< 1	85	0.00	< 1
Total debt	**13,692**	**5.81**		**15,465**	**5.39**	
Short-term investments	8,074	0.23	< 1	7,133	0.36	< 1
Long-term investments[2]	11	6.23	-	11	5.26	-
Bank overdraft less cash	(1,859)		-	(1,805)		-
Total investments	**6,226**	**0.24**	-	**5,339**	**0.37**	-

[1] weighted average rate on borrowing/investments at 31 March (for illustrative purposes only)

[2] Not including 'policy investments' falling outside of the Councils Treasury Management and Investment Strategies

4.0 The Strategy for 2017/18

4.1 The expectation for interest rates within the Treasury Management Strategy Statement for 2017/18 (approved by members on 1 March 2017) was that the Bank Rate would not start rising from 0.25% until quarter 2 (April to June) of 2019 and then only increase once more (from 0.5% to 0.75%) before 31.3.20. There would also be 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.

4.2 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.

4.3 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.

5.0 The Borrowing Requirement

5.1 The Council's underlying need to borrow to finance capital expenditure is measured by the Capital Financing Requirement (CFR). The CFR represents the historic cost of capital expenditure that has yet to be financed by setting aside resources (grants, contributions, capital receipts and revenue financing).

5.2 Capital expenditure that is not financed when incurred, through the application of capital grants, contributions, capital receipts or a direct charge to revenue will increase the capital financing requirement. It will also give rise to a requirement to make an annual charge to the general fund known as the minimum revenue provision (MRP). Charging the minimum revenue provision or a voluntary revenue provision (in addition to the MRP) against the general fund will reduce the CFR.

5.3 The Council's Treasury Management Strategy Statement for 2017/18 included an expected net increase in the CFR of £1.33m during 2017/18. This increase was based on the Council's approved 2017/18 capital budget and was later revised to £1.969m to reflect 2016/17 outturn position and 2016/17 budget carry forwards incorporated into the 2017/18 revised capital budget. The 2017/18 Treasury Management Strategy Statement also highlighted that the Council would need to undertake additional external borrowing of up to £4.7m during the year in order to fund its capital programme. Details of actual borrowing transactions undertaken in 2017/18 are summarised in section 7.

5.4 At 31 March 2018 the Council's capital financing requirement stood at £18.917m compared to £18.674m at 31 March 2017. The increase of £243k over the course of 2017/18 reflects:

- an increase of £866k relating to unfinanced capital expenditure incurred during the year
- a reduction of £623k resulting from amounts set aside from revenue (the minimum revenue provision), calculated in accordance with the approved MRP Policy Statement for 2017/18.

Table 2: Capital Financing Requirement

	31.3.17 Estimate £000	31.3.17 Actual £000	31.3.18 Approved Estimate £000	31.3.18 Updated Estimate[1] £000	31.3.18 Actual £000
CFR at 31 March	19,637	18,674	20,967	20,643	18,917

[1] reported in mid-year review based on revised capital budget

5.5 The variance of £1.726m between the actual and updated estimate of the CFR at 31 March 2018 comprises:

- £1.635m relating to the unfinanced portion of approved 2017/18 capital budget carry forwards (i.e. the amount funded from borrowing) of £2.786m
- £0.091m reduction in unfunded capital expenditure associated with the reported net underspend (after budget carry-forwards) of £0.114m.

5.6 Capital budget carry-forwards of £2.786m were approved as part of the 2017/18 Capital Outturn report presented to the Council's Executive on 13 June 2018. These carry-forwards are associated with the re-profiling of expenditure from 2017/18 to 2018/19 on the following capital schemes:

- Strategic Acquisitions - carry forward £0.746m (£0.746m unfinanced)
- Lilly Hall - Land Purchase - carry forward £0.753k (£0.371m unfinanced)
- Lillyhall Development - carry forward £200k (£0 unfinanced)
- Reedlands Road Development - carry forward £0.250m (£0.250m unfinanced)
- Public Toilets Review Works - carry forward £0.114m (£0.075m unfinanced)
- Helena Thompson Museum Development - carry forward £0.180m (£0 unfinanced)
- Housing Improvement Projects - carry forward £0.145m (£0 unfinanced)
- Other schemes - carry forward £0.398m (£0.193m unfinanced).

6.0 Public Works Loan Board (PWLB) Borrowing Rates in 2017/18

6.1 The graphs and tables below and in appendix B show, for a selection of maturity periods, the high and low points for PWLB certainty maturity rates, the average rates, spreads and individual rates at the start and the end of the financial year.

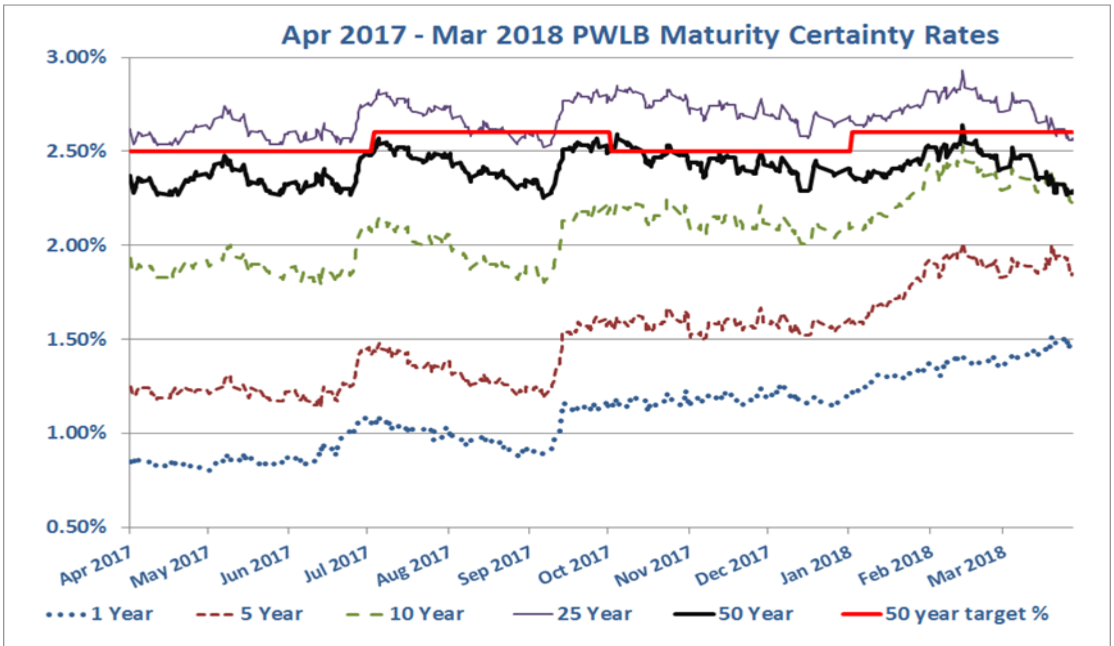
6.2 As depicted in the graph below during 2017/18, volatility in gilt yields resulted in significant volatility in PWLB 25 and 50 year borrowing rates. However in overall terms there has been little consistent trend in longer-term rates during the financial year. In contrast, shorter rates were on a notable rising trend during the second-half of the year and reached peaks in February and March 2018.

6.3 PWLB rates varied little during the first quarter of 2017/18 before rising sharply in the last week of June following the outcome of the general election in early June. After falling during the middle part of quarter 2, the final weeks of quarter 2 saw significant increases in rates following the September MPC meeting and the suggestion that the Bank Rate would need to increase sooner than markets had previously anticipated, partly because of inflation concerns and also because of the tightening labour market.

6.4 After reaching peaks in October, rates subsequently fell back during the latter half of quarter 3 (October to December). This was followed by a rising trend in the first half of quarter 4 (January to March), before falling back during the remainder of the period to the end of March.

6.5 At 31 March 2018 the 50 year PWLB certainty rate for new loans stood at 2.29% (fixed) compared to 2.34% at 1 April. The 25-year rate ended the year at 2.57% compared to 2.6% at 1 April 2017. This compares with updated forecasts included in the Mid-year report for 50 and 25 year maturities at the end of 2017/18 of 2.9% and 2.7% respectively.

Graph 1: PWLB borrowing rates 2017/18



7.0 Borrowing Activity in 2017/18

7.1 A summary of borrowing transactions undertaken during 2017/18 is included in the following table (table 3).

Table 3: External borrowing activity during 2017/18

	01-Apr-17 £'000	New Borrowing £'000	Borrowing Repaid £'000	Other Movements £'000	31-Mar-18 £'000
Long-term					
PWLB – fixed rates	13,607	2,000	(227)	0	15,380
Short-term					
Local Bonds	31	0	0	0	31
Trust Funds	54	0	0	0	54
	13,692	**2,000**	**(227)**	**0**	**15,465**

7.2 During the year the Council drew down £2m of additional loan funding from the Public Works Loan Board (PWLB) to fund the net unfinanced capital expenditure. The loan was drawn down in March 2018 on the following terms:

- repayment method - equal instalment of principal
- interest rate - 2.44% (fixed)
- term - 25 years.

7.3 Scheduled loan repayments of £227k were made during the year to March 2018.

7.4 The Council's 2017/18 Budget and Treasury Management Strategy Statement anticipated additional PWLB borrowing during 2017/18 of up to £4.7m to fund the Council's capital programme. This included £3m of borrowing deferred from 2016/17. As a result of changes included in the Council's revised 2017/18 capital programme, including the impact of re-profiling of expenditure funded from borrowing between financial years to reflect anticipated project delivery timetables, the anticipated (maximum) additional external borrowing requirement in 2017/18 was subsequently revised down to £3.93m.

7.5 This re-profiling of capital expenditure, coupled with reported underspends on the 2017/18 revenue and capital budgets, has contributed positively to the Council's ability to meet its liquidity requirements by utilising cash from reserves, revenue balances and favourable in year cash flows. As a consequence, the actual amount of external borrowing undertaken in 2017/18 was reduced to £2m.

7.6 The reduction in the amount of new borrowing undertaken during the financial year as a result of reprofiling capital expenditure, coupled with the Council's policy of using internal borrowing to avoid or postpone the timing of any new borrowing, has meant that during the year its was able to secure:

- savings - included in the 2017/18 revised budget - of £68k against the original budget for interest costs
- a favourable outturn variance in interest payable - compared to the revised budget - of £52k.

7.7 At 31 March 2018 the Council's PWLB loan portfolio consisted of fixed rate:

- maturity loans totalling £8.0m (31 March 2017: £8m)
- annuity loans of £1.70m (31 March 2017: £1.767m)
- EIP loans of £5.68m (31March 2017: £3.84m).

7.8 Interest rates applying to individual loans within the Council's PWLB loan portfolio range from 2.44% to 9.5%. At 31 March 2018 the weighted average rate of interest payable on the Council's PWLB loan portfolio stood at 5.42% (31 March 2017: 5.85%). Whilst this remains above current rates applicable to new PWLB borrowing (see Appendix B) - reflecting the historic nature of the Council's PWLB loans portfolio - no rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature redemption rates made rescheduling unviable.

7.9 At 31 March 2018 the 'fair value' of the Council's PWLB loans portfolio - measured using PWLB premature repayment rates - was £29.598m (31 March 2017: £28.122m) .The difference of £14.218m - between this and the principal outstanding (£15.38m) - reflects the premium that would be payable to repay those loans prematurely (£14.022m), plus interest accrued from the previous scheduled repayment date (£0.196m).

7.10 At 31 March 2018, the weighted average life of the Council's PWLB loan portfolio was approximately 25 years (31 March 2017: 27 years). The weighted average time to maturity of these loans was 30 years (31 March 2017: 31 years).

8.0 Investment Rates in 2017/18

8.1 Deposit rates continued into the start of 2017/18 at previous depressed levels and have remained low throughout 2017/18. This is due, in part, to the impact of the Bank of England's quantitative easing programme and the large tranche of cheap borrowing made available for banks to use to lend to businesses and individuals under the Term Funding Scheme which ended on 28 February 2018.

8.2 During the first three months of the financial year, investment rates available in the market were on a slight declining trend. A rise in over three month rates during the latter half of June was followed by a slight declining trend during most of the three months to the end of September. With the exception of the 7-

day rate, rates subsequently moved up sharply after the MPC meeting of 14 September abruptly raised expectations of how soon the Bank Rate was likely to go up.

8.3 Over the course of the second half of the year, investment rates for maturities of 3 months and longer were on a rising trend, reflecting the expectation of the Bank Rate increasing from its floor of 0.25%. Rates rose sharply after the MPC meeting minutes published on 8 February indicated a faster pace of increases in the bank rate than had previously been expected and reached a peak at the end of March 2018.

8.4 During the first six months of the year, the 7-day rate remained broadly stable, fluctuating between a high of 0.12% and a low of 0.10%.

8.5 The Bank rate was increase from 0.25% to 0.5% on 2 November 2017 and has remained at that level for the rest of the year. However, further increases are expected over the next few years.

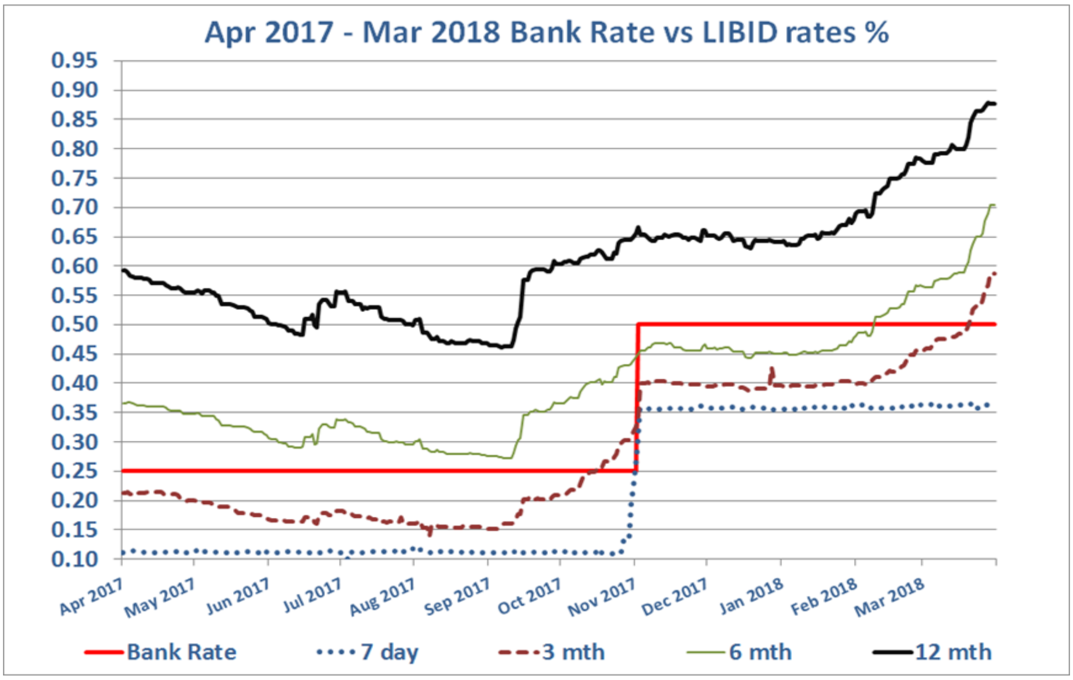
8.6 Following the Bank of England's decision on 2 November to reverse the emergency cut in the Bank rate, implemented in August 2016, and increase the bank rate by 25bps the 7-day rate rose sharply. Thereafter the rate has remained broadly stable fluctuating between a high of 0.37% and a low of 0.35% between 2 November and 31 March 2018. The average 7- day rate for the six months to September was 0.11% (2016/17: 0.28%). The average for the second half year was 0.32% (2016/17: 0.12%).

8.7 The Council's 2017/18 TMSS included a forecasted increase in the bank rate from 0.25% to 0.50% in quarter 2 (April to June) of 2019. Over the course of the year, the rise in the bank rate, coupled with changes in market expectations as to the pace and timing of monetary tightening saw several changes to the forecast timing of further increases in the Bank rate. However, previous expectations that the scale of future increases in the bank rate will be gradual and to a limited extent, remain.

8.8 Following the 0.25% increase in the Bank Rate in November 2017 and forward guidance issued by the Monetary Policy Committee at that time, indicating that they expected to increase the Bank Rate only twice more by 0.25% by 2020 to end at 1.00%, forecasts provided by the Authority's Treasury advisors - Link Asset Services – included three further increases in the Bank rate of 0.25% in November 2018, November 2019 and August 2020.

8.9 Following publication of the Bank of England Inflation Report in February 2018 and the minutes of the February MPC meeting, a further Bank Rate increase (from 0.5% to 0.75%) during the quarter ending June 2018 was added to the previous forecasts. At that time further increases of 0.25% were forecasted in quarter 4 (October to December) 2018 (from 0.75% to 1%), quarter 4 2019 (from 1%to 1.25%) and quarter 3 (June to September) 2020 (from1.25% to 1.50%). As late as mid-February, financial markets were viewing a May Bank Rate increase as a near dead certainty. However, since mid-February a sharp downturn of economic data in quarter 1 saw the MPC leave the Bank Rate unchanged in May. The forecast timing of the next bank Rate increase was subsequently pushed back from May 2018 to November 2018 with further 25bp increases expected to follow in September 2019 (Q3), June 2020 (Q2) and November 2020 (Q4). Since May an upturn in the economic data has however seen opinion turn to suggest the possibility of an increase in the Bank Rate as early as August.

Graph 2: Investment Rates in 2017/18



9.0 Investment Outturn for 2017/18

9.1 The Council's investment policy is set having regard to the MHCLG's Guidance on Local Government Investments ('MHCLG Investment Guidance') and CIPFA's Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes ('the Treasury Management Code').

9.2 The Council's investment policy for 2017/18 was set out in the Treasury Management Strategy Statement and Investment Strategy approved by Council on 1 March 2017. The contents of this policy include:

- procedures for determining the counterparties with whom investments may be placed, including the use of credit ratings and other sources of information to assess credit and counterparty risk
- the types of investment instruments that may be used
- limits on the amount that may be invested with any single institution or group of institutions
- limits on the maximum period for which funds may be prudently committed.

9.3 Investment activity during the year - excluding 'policy investments' falling outside of the Councils Treasury Management and Investment Strategies - is summarised in the following table:

Table 4: Investment activity during 2017/18

	Credit Rating	1 April 2017 £'000	Investments Made £'000	Investments Repaid £'000	31 March 2018 £'000
Specified Investments					
Call Accounts	AA-	2,000	16,070	(17,248)	822
Call Accounts	A / A-	419	23,838	(23,461)	796
Notice Accounts	A	0	0	0	0
Money Market Funds	AAA	5,655	57,925	(58,065)	5,515
Non Specified Investments					
Equity Shares	Not rated	11	0	0	11
		8,085	**97,833**	**(98,774)**	**7,144**

9.4 Investment activity during the year complied with the Council's approved strategy and the Council had no liquidity difficulties. In keeping with MHCLG's guidance on local authority investments, the Council maintained a sufficient level of liquidity through the use of money market funds, call and notice accounts. All (specified) investments made during 2017/18 had a maximum maturity not exceeding 364 days (from the date of acquisition).

9.5 During 2017/18 the Council maintained an average short-term investment balance of internally managed funds of £13.2m (2016/17: £16.0m). These funds earned an average rate of return of approximately 0.24% (2016/17: 0.33%). This compares favourably with the Council's benchmark return (the average 7- day LIBID rate) over the year of 0.21% (2016/17: 0.20%). Interest and dividends earned on investments (long-term and short-term) during 2017/18 was £32,137 (2016/17:£52,859) compared to a revised budget of £21,000.

Credit Risk

9.6 The Council's prime policy objective of its investment activity is to ensure the security of principal sums invested in priority to liquidity and yield.

9.7 Ensuring the security of principal sums invested is achieved through active management of the Council's credit risk exposures. This includes placing restrictions and limits on:

- the counterparties with whom investments may be placed based on the creditworthiness of the counterparty
- the types of investment instruments that may be used
- the amount invested with any single institution or group of institutions on the Council's list of approved counterparties
- the duration of individual investment instruments depending on the financial standing (creditworthiness) of the counterparty.

9.8 Whilst published credit ratings remain the primary means of assessing the credit worthiness of counterparties, the Council continues to make use of other sources of information on credit risk before making investment decisions. This includes:

- ratings outlooks (indicating the likely direction of an issuer's rating over the medium term)
- credit watches and watchlists (indicating that downgrading or upgrading of the credit rating could be imminent)
- sovereign ratings and support mechanisms
- credit default swap (CDS) spreads (indicating perceived market sentiment regarding the credit risk associated with a particular institution and an early warning of potential creditworthiness problems which may only belatedly lead to actual changes in credit ratings).

9.9 In accordance with the Council’s Annual Investment Strategy, all counterparties used during 2017/18 were restricted to financial institutions and other bodies with a minimum long-term rating across all three of the main credit ratings agencies (Fitch, Moody’s and Standard & Poor’s) of A- or equivalent (AA+ or equivalent for non-UK sovereigns).

9.10 None of the investments made by the Authority during 2017/18 were with counterparties holding a credit rating below the Council’s minimum credit rating threshold.

9.11 With the exception of funds placed with HM Treasury’s Debt Management Office (DMO), the maximum amount that may be placed with any institution or group of institutions that are part of the same banking group is £4m. For funds placed with the DMO’s Account Deposit Facility the current limit is £12m. There were no breaches of these counterparty exposure limits during the financial year.

10 Prudential Indicators.

10.1 The Local Government Act 2003 requires the Council to determine and keep under review limits on how much money it can afford to borrow by way of loans and other forms of credit (for example finance leases). The process the Council must follow in setting these limits (the ‘Authorised Limit for External Debt’) is set out in the Prudential Code for Capital Finance in Local Authorities, to which the Council is required to ‘have regard to’ under provisions contained in the 2003 Act.

10.2 In addition to the Authorised Limit, CIPFA’s Prudential and Treasury Management Codes and accompanying the sector guidance include a number of other key treasury management indicators designed to ensure the Council operates its treasury activities within well-defined limits. These include:

- setting an operational boundary for external debt based on the expectations of the most likely maximum external debt for the year
- ensuring that gross debt does not, except in the short term, exceed the Capital Financing Requirement (CFR) - the undeylying need to borrow

for capital purposes - at the end of the preceding year plus the estimates of any additional CFR for current and the following two financial years

- placing upper limits on the total of principal sums invested longer than 364 days
- placing upper and lower limits on the maturity structure of borrowings.

10.3 The Council's Authorised Borrowing Limit (the statutory limit on borrowing under the Local Government Act 2003), Operational Boundary (the limit beyond which external debt is not expected to exceed) and other indicators and limits required by CIPFA's Prudential and Treasury Management Codes, were set out in the Council's Treasury Management Strategy Statement and Investment Strategy for 2017/18 and approved by members on 1 March 2017.

10.4 During 2017/18 the Council complied with the limits established by the Prudential and Treasury indicators included in its Treasury Management & Investment Strategy for 2017/18, Further details are set out in Appendix A.

11 Other Issues

Revisions to statutory framework

11.1 The statutory framework for treasury management and capital finance within local authorities is laid out in a series of legislations, statutory guidance and codes of practice. During 2017/18 the codes of practice issued by CIPFA and the statutory guidance issued by MHCLG were reviewed and updated. This resulted in the publication of revised editions of:

- The CIPFA Prudential Code for Capital Finance in Local Authorities ('the Prudential Code') and
- The Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes - ('the Treasury Management Code') - issued by CIPFA
- Ministry of Housing, Communities and Local Government statutory guidance on:
    - Local Government Investments, and
    - Minimum Revenue Provision.

11.2 Key changes to the statutory framework include:

- the introduction of more contextual reporting through the requirement to produce a capital strategy setting out the long-term context in which capital expenditure and investment decisions are made and providing a high level overview of :
    - how capital expenditure, capital financing and treasury management activity contribute to the provision of services and the delivery of service objectives
    - how associated risk is managed, and
    - the implications for future financial sustainability

- removal of a number of previously mandated Prudential Indictors
- an extension of MHCLG investment guidance to cover investments (both financial and non-financial) not held for treasury management purposes
- new or clarified guidance on the impact of changing methods of calculating MRP, asset lives, the meaning of 'charge to a revenue account' and the treatment of investment properties and overpayments of MRP.

11.3 The revised editions of the Prudential and Treasury Management Codes and statutory guidance on Local Government Investments, are effective for 2018/19 and subsequent years. Full implementation in 2018/19 is however subject to the transitional arrangements set out in the statutory guidance and the recommendations issued by CIPFA's Treasury and Capital Management Panel (in relation to the requirement to produce a capital strategy and changes to a number of treasury management indicators).

11.4 The updated MRP guidance is applicable from 1 April 2019, although early adoption is encouraged. This is with the exception of those changes relating to guidance on changing methods for calculating MRP, which apply from 1 April 2018.

11.5 The revisions made to the statutory framework in respect of treasury management activities were incorporated into the content of the 2018/19 TMSS, Investment Strategy and MRP policy documents approved by Council in March 2018.

Markets in Financial Instruments Directive II (MiFID II)

11.6 The Market in Financial Instruments Directive II (MIFID II) reforms came into force on 3 January 2018. The regulations govern the relationship that financial institutions conducting lending and borrowing will have with local authorities. MiFID II is focussed on regulated products. These include direct investments such as Certificates of Deposit, Gilts, Corporate Bonds and investment funds, including Money Market Funds. It does not cover simple term deposits.

11.7 MiFID II changes the classification of local authority investors. Under MiFID II the Financial Conduct Authority is obliged to treat all local authorities as retail investors under European Union legislation. Whilst classification as a retail, rather than professional investor, offers greater regulatory protection, it also limits the range of financial investment instruments that can be accessed. Authorities may however elect for a return to professional status by "opting up" to an Elective Professional Client status provided they meet certain qualitative and quantitative criteria.

11.8 In order to maintain access to the Money Market Funds on its approved lending list the Authority has, where necessary, been successful in securing Elective Professional Client status with the financial institution concerned.

Appendix A: Prudential and treasury indicators

1 Indicators required by the Prudential Code

1.1 The Prudential Code requires local authorities to self-regulate the affordability, prudence and sustainability of their capital expenditure and borrowing plans, by setting estimates and limits, and by publishing actuals for a range of prudential indicators. It also requires them to ensure their treasury management practices are in accordance with good practice.

1.2 The prudential and treasury indicators required by the Prudential Code and the Treasury Management Code and accompanying sector guidance are designed to support and record local decision making. They are not designed to be comparative performance indicators and should not be used for this purpose.

1.3 The Council's performance compared to the limits and estimates set out in the Council's 2017/18 Treasury Management Strategy Statement for and 2017/18 Mid-year Treasury Update Report are summarised in the following sections.

2 Actual capital expenditure

2.1 Table A shows the actual capital expenditure incurred during 2017/18.

Table A: Actual capital expenditure

	2016/17 Actual £000	2017/18 Approved £000	2017/18 Revised estimate[1] £000	2017/18 Actual £000
General Fund Capital Expenditure	3,746	9,401	5,935	2,790
Financed by:				
Capital receipts	312	0	280	3
Capital grants & contributions	1,367	7,426	2,090	1,668
Revenue	293	0	973	253
Total expenditure financed in year	1,972	7,426	3,343	1,924
Unfinanced capital expenditure:				
Supported borrowing	0	0	0	0
Unsupported borrowing	1,774	1,975	2,592	866
Total financed & unfinanced	3,746	9,401	5,935	2,790

[1] 2017/18 revised capital budget

2.2 Capital expenditure is defined in section 16 of the Local Government Act 2003 and includes all expenditure that falls to be capitalised in accordance with proper practices together with any items capitalised in accordance with regulation 25 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (as amended), or by virtue of a capitalisation direction issued under section 16(2) of the 2003 Act.

2.3 The variance of £3.145m between the outturn position (£2.790m) and the 2017/18 revised estimate (£5.935m) comprises:

- budget carry forwards of £2.787m
- amounts written-off to revenue of £244k
- net variance (underspend) of £114k.

2.4 Approved budget carry forwards of £2.787m reflect changes to the expected timing of expenditure on individual schemes (rather than the overall amount of expenditure) and subsequent budget revisions to reflect the re-profiling of expenditure across the 2017/18 and 2018/19 financial years. Further details relating to the capital outturn position for 2017/18 can be found in the Capital Outturn report considered by the Council's Executive on 13 June 2018. The net variance on the capital budget after accounting for budget carry-forwards was £114k.

3 Actual Capital Financing Requirement

3.1 The Capital Financing Requirement (CFR) is a measure of an authority's underlying need to borrow for capital purposes. It represents the historic cost of capital expenditure that has yet to be financed by setting aside resources (grants, contributions, capital receipts and revenue financing). It does not necessarily correspond with an authority's actual borrowing position which is determined in accordance with an authority's treasury management strategy and practices. Table B shows the Council's actual capital financing requirement at 31 March 2018.

Table B: Capital financing requirement

	2016/17 Actual £000	2017/18 Approved estimate £000	2017/18 Revised estimate £000	2017/18 Actual £000
CFR at 1 April	17,449	19,637	18,674	18,674
CFR at 31 March	18,674	20,967	20,643	18,917
Movement in CFR	1,225	1,330	1,969	243
Movement represented by:				
Unfinanced expenditure	1,774	1,975	2,592	866
Revenue financing of 15/16 expenditure	(138)	0	0	0
Less MRP	(411)	(645)	(623)	(623)
Less Voluntary set aside	0	0	0	0
Movement in CFR	1,225	1,330	1,969	243

[1] Updated to reflect 2017/18 revised capital budget

4 Gross debt and the capital financing requirement (CFR)

4.1 A fundamental provision of the Prudential Code and a key indicator of prudence is that, over the medium term, debt will only be for a capital purpose. In order to ensure this is the case, gross external debt should not, except in the short term, exceed the total of the capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years.

4.2 This requirement allows some flexibility for limited early borrowing for future years but ensures that borrowing is not undertaken for revenue purposes. Gross debt refers to the sum of borrowing and other long-term liabilities (credit arrangements). Table C compares the Council's gross debt and CFR.

Table C: Gross debt & the CFR

	2016/17 Actual £000	**2017/18 Approved (max) £000**	**2017/18 Revised estimate[1] £000**	**2017/18 Actual at 31.3.18 £000**
PWLB	13,607	18,337	13,380	15,380
Other borrowing	85	94	85	85
Total debt	**13,692**	**18,431**	**13,465**	**15,465**
CFR at 1 April	17,449	19,637	18,674	18,674
Add: Unfinanced capital expenditure	1,774	1,975	2,592	866
Revenue financing of 15/16 expenditure	(138)	0	0	0
Less: MRP	(411)	(645)	(623)	(623)
CFR at 31 March	**18,674**	**20,967**	**20,643**	**18,917**
(Under)/Over borrowing	(4,982)	(2,536)	(7,178)	(3,452)

[1] based on the maturity profile of the Council's loan portfolio at 30.9.17

4.3 At 31 March 2018 the Council was under-borrowed against its capital financing requirement by £3.452m. This compares with an under-borrowed position at 31 March 2017 of £4.982m. The decrease of £1.530m during 2017/18 is represented by:

- a net increase in external borrowing of £1.773m, plus
- a reduction in the CFR of £0.623m reflecting amounts set aside from revenue in 2017/18 (the minimum revenue provision), less
- an increase in the CFR of £0.866m as a result of unfinanced capital expenditure incurred during the year.

5. Authorised limit for external debt

5.1 The Authorised Borrowing Limit represents the statutory limit on borrowing determined under section 3 of the Local Government Act 2003 (Affordable Limit). It imposes an upper limit on the Council's gross external debt (excluding investments), separately identifying borrowing (external loans) from other long-term liabilities (for example finance lease liabilities). Breach of the Affordable Borrowing Limit is prohibited by section 2(1) (a) of the Local Government Act 2003.

5.2 The Authorised Borrowing Limit is set with reference to the Council's capital expenditure plans, capital financing requirement (or underlying borrowing requirement) and the potential need to borrow to meet temporary revenue borrowing requirements pending the receipt of amounts due to the Council. The Affordable Borrowing Limit also includes headroom over and above the Operational Boundary (see below) to accommodate any unusual or unforeseen cash movements. The indicator separately identifies limits for borrowing and other long-term liabilities.

Table D: Authorised Limit for External Debt

	2017/18 Approved £000	2017/18 Revised £000	31.3.18 Actual £000	2017/18 Actual (max) £000
Borrowing	25,000	25,000	15,465	15,380
Other long-term liabilities	0	0	0	0
Total	25,000	25,000	15,465	15,380

6 Operational boundary for external debt

6.1 The Operational Boundary represents the limit beyond which (gross) external debt is not expected to exceed. It is based on expectations of the maximum external debt of a local authority according to probable events (that is, the most likely (prudent) but not worst case scenario) and is consistent with the maximum level of external debt projected by these estimates. The Operational Boundary links directly to the Council's plans for capital expenditure, estimates of the capital financing requirement and cash flow requirements for the year for all purposes but without the additional headroom included within the Authorised Limit. The indicator separately identifies limits for borrowing and other long-term liabilities.

Table E: Operational boundary for external debt

	2017/18 Approved £000	2017/18 Revised £000	31.3.18 Actual £000	2017/18 Actual (max) £000
Borrowing	23,000	23,000	15,465	15,465
Other long-term liabilities	0	0	0	0
Total	23,000	23,000	15,465	15,465

7 Estimates of the ratio of financing costs to net revenue stream

7.1 This indicator of affordability highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs (net of interest and investment income).

Table F: Ratio of Financing Costs to Net Revenue Stream

	2016/17 Actual %	2017/18 Approved %	2017/18 Revised %	2017/18 Actual %
Ratio	7.4	10.3	9.5	9.0

7.2 Financing costs comprise the aggregate of:

- interest charged to the General Fund with respect to borrowing
- interest payable under finance leases and other long-term liabilities
- premiums and discounts from debt restructuring charged or credited to the amount to be met from government grants and local taxpayers
- interest and investment income (excluding interest on policy investments falling out with the Councils Treasury Management and Investment Strategies)
- amounts payable or receivable in respect of financial derivatives
- minimum revenue provision plus any additional voluntary contributions
- any amounts for depreciation/impairment charged to the amount to be met from government grants and local taxpayers.

7.3 Actual figures for Net Revenue Stream are taken from the Council's Comprehensive Income and Expenditure Statement for 'taxation and non-specific grant income and expenditure'.

8.0 Indicators required by the Treasury Management Code

8.1 In addition to the indicators required by the Prudential Code there are also a number of treasury indicators required by the Treasury Management Code and accompanying sector guidance. These are:

- upper and lower limits to the maturity structure of its (fixed rate) borrowing
- upper limits on the total of principal sums invested longer than 364 days.

8.2 These treasury management indicators specify ranges (rather than targets) designed to limit the Council's exposure to interest rate, liquidity and refinancing risks.

9 Upper and lower limits to the maturity structure of fixed rate borrowing

9.1 This indicator highlights potential exposures to refinancing risk arising from concentrations of fixed rate debt falling due for refinancing and is designed to facilitate reductions in the Council's exposure to refinancing at times of volatile or high interest rates.

9.2 It is calculated as the amount of borrowing that is fixed rate maturing in each period as a percentage of total borrowing that is fixed rate. The maturity of borrowing is determined by reference to the earliest date on which the lender can require payment.

Table G: Lower/upper limits on % of fixed rate borrowing maturing in each period

	At 31.3.17 Actual %	Lower limit 2017/18 %	Upper limit 2017/18 %	At 31.3.18 Actual %
Under 12 months	1.89	0	20	2.23
12 months to 2 years	1.71	0	20	2.08
2 years to 5 years	5.44	0	20	6.52
5 years to 10 years	10.41	0	30	12.17
10 years to 20 years	17.20	0	40	19.38
20 years to 30 years	4.69	0	40	5.71
30 years to 40 years	51.33	0	80	51.91
40 years to 45 years	7.33	0	80	0

10 Upper limits to the total of principal sums invested longer than 364 days

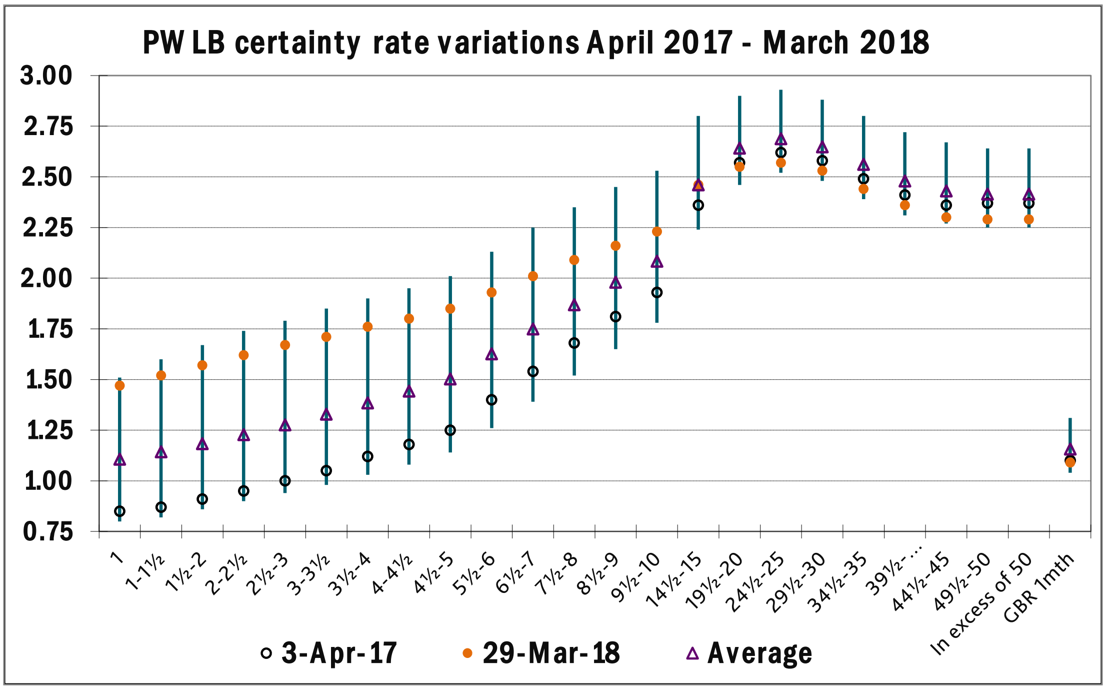
10.1 A local authority that invests, or plans to invest, for periods longer than 364 days is required to set an upper limit for each forward financial year period for the maturing of such investments. The purpose of the limit for principal sums invested for periods longer than 364 days is to contain the Council's exposure to the possibility of loss that might arise as a result of its having to seek early repayment or redemption of principal sums invested.

Table H: Upper limit for principal sums invested to final maturities beyond the period end

	2016/17 Actual £000	2017/18 Approved £000	2017/18 Revised £000	2017/18 Actual £000
Principal sums invested > 364 days	11	50	50	11

[1] Measured at fair value. The nominal value (historic cost) of principal sums investment as 31 March 2018 is £1k

Appendix B



PWLB Certainty Rates 2017-18

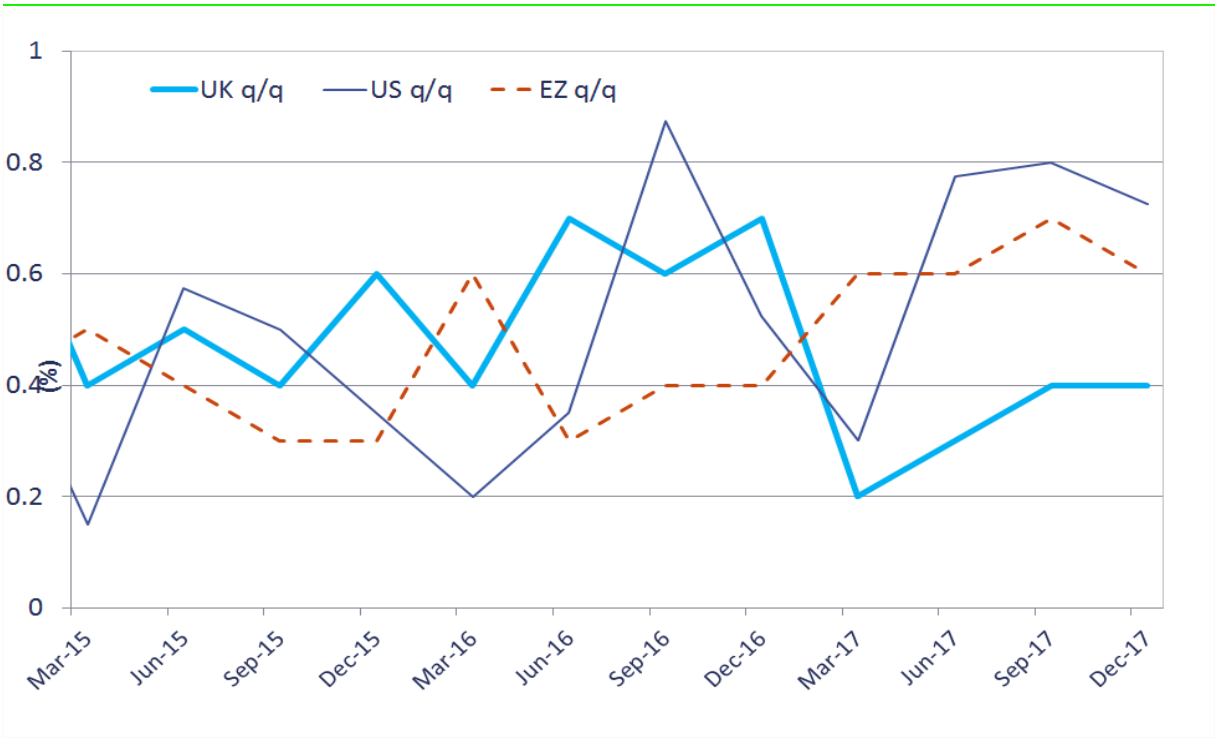
	1 year	4½ -5 year	9 ½-10 year	24½-25 year	49½-50 year
01/04/2017	0.85%	1.25%	1.96%	2.62%	2.37%
31/03/2018	1.47%	1.85%	2.23%	2.57%	2.29%
Low	0.80%	1.14%	1.78%	2.52%	2.25%
Date	03/05/17	15/06/17	15/06/17	08/09/17	08/09/17
High	1.51%	2.01%	2.53%	2.93%	2.64%
Date	21/03/18	15/02/18	15/02/18	15/02/18	15/02/18
Average	1.11%	1.50%	2.08%	2.69%	2.41%

Money market investment rates 2017-18

	7 day	1 month	3 month	6 month	1 year
01/04/2017	0.111%	0.132%	0.212%	0.366%	0.593%
31/03/2018	0.364%	0.386%	0.587%	0.704%	0.878%
High	0.366%	0.390%	0.587%	0.704%	0.879%
Low	0.099%	0.122%	0.140%	0.273%	0.461%
Average	0.215%	0.233%	0.286%	0.401%	0.606%
Spread	0.267%	0.268%	0.447%	0.432%	0.418%
High date	27/02/2018	22/03/2018	29/03/2018	29/03/2018	28/03/2018
Low date	04/07/17	10/08/17	07/08/17	07/09/17	06/09/17

Appendix C

UK, US and EZ GDP growth



Inflation UK, US, Germany and France