Appendix C

Annual Treasury Management Report 2017/18

1. Introduction

1.1. The council's treasury management activity is underpinned by CIPFA's Code of Practice on Treasury Management. Before the start of every year the Code requires local authorities to produce Prudential Indicators and a Treasury Management Strategy Statement detailing the policies and objectives of the council's treasury management activities for the forthcoming year. This outturn report compares actual activity to those policies and objectives.

1.2. The council borrows and invests substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of these risks are central to the treasury management strategy.

2. Economic Background

2.1. **Growth:** During the first half of 2017 growth was disappointingly weak. The main reason for this was the sharp increase in inflation caused by the devaluation of sterling after the EU referendum. However, growth did pick up modestly in the second half of 2017.

2.2. **UK Monetary Policy**: On 2 November the Monetary Policy Committee (MPC) raised the bank rate from 0.25% to 0.50%. The 8 February MPC meeting minutes warned for more imminent and faster paced increases in the bank rate.

2.3. **Inflation:** CPI inflation ended the year at 2.7% and was forecast to remain just over 2% within 2 years.

3. Borrowing

3.1. The council continues to access lower cost short-term loans from other local authorities rather than more expensive longer term debt due to the differential between short and longer-term interest rates. This policy is expected to continue in 2018/19 but should this differential decrease and short term borrowing costs increase, the council will begin securing additional fixed long term debt to fund its borrowing requirements.

3.2. In 2017/18 the weighted average interest rate paid on council borrowing was 3.48% (3.24% in 2016/17). The weighted average cost of long term borrowing was 3.88% compared to 0.70% for short-term borrowing (being the gross cost including brokers' commission of between 0.03% and 0.06%).

3.3. It is council strategy to maintain borrowing and investments below their underlying levels by using "internal borrowing", utilising usable reserves. This maintains borrowing and investment balances to a minimum.

3.4. During 2017/18 Public Works Loan Board (PWLB) have increased their lending rates correspondingly to the developments noted in the economic background section above, with shorter term rates increasing more sharply than longer term rates.

3.5. The premium charged by the PWLB for the early repayment of PWLB debt remained too expensive for existing loans in the council's portfolio to be repaid and rescheduled. No rescheduling activity was undertaken in 2017/18, this option will continue to be constantly considered.

3.6. Borrowing activity during the year is summarised below:

Borrowing Activity in 2017/18	**01/04/17 Balance £m**	**New Borrowing £m**	**Debt Maturing £m**	**31/03/18 Balance £m**
Short-term borrowing	28.00	10.00	(33.00)	5.00
Long-term borrowing	148.49	0.00	(5.44)	143.05
TOTAL BORROWING	**176.49**	**10.00**	**(38.44)**	**148.05**
Other long-term liabilities*	57.41	0.27	(2.24)	55.44
TOTAL EXTERNAL DEBT	**233.90**	**10.27**	**(40.68)**	**203.49**
**Other long term liabilities represent existing commitments under PFI arrangements included in the medium term financial strategy*				

3.7. Total borrowing decreased by £28.4m due to repayments exceeding the need to borrow to fund capital programme spend in 2017/18.

3.8. The council's underlying need to borrow as measured by the Capital Financing Requirement (CFR). As at 31/03/2018 this totalled £314.6m. The difference of £111.1m between the CFR and total external debt represents internal borrowing from usable reserves, which totalled £112.1m, working capital balances and the outstanding loan balance with Mercia waste of £37.1m.

3.9. The council's capital financing costs in 2017/18 were as follows.

Capital financing costs for 2017/18:	**Budget**	**Outturn**	**Over / (under) spend**
	£m	**£m**	**£m**
Minimum Revenue Provision (provision for repayment of loan principal)	**11.1**	**6.0**	**(5.1)**
Interest payable on all loans	**6.8**	**5.8**	**(1.0)**
TOTAL	**17.9**	**11.8**	**(6.1)**

3.10. The variances to budget have arisen from:

- The change to the Council's Minimum Revenue Provision Policy (MRP) in the year. This decision means that the MRP is now calculated on an annuity basis, resulting in an in year saving. This saving has been added to the Council's usable revenue reserves.
- The underspend on interest payable rose to £978k on outturn due to interest charges on short term loans being lower than budgeted and utilised less than expected.

4. <u>Investments</u>

4.1. The council invests significant funds, representing income received in advance of expenditure plus balances and reserves. During 2017/18 the council's investment balances averaged at £22m and ranged from £3m in April 2017 to £45m in February 2018.

4.2. Security of capital remained the council's primary objective. Investment income remained low due to the continued low interest rate environment.

4.3. Investments held at the start and end of the year were as follows:

Investments	01/04/17 Balance £m	Investments Made £m	Maturities/ Withdrawals £m	31/03/18 Balance £m
Instant Access Accounts	2.97	319.13	(312.98)	9.12
Notice Accounts	-	5.00	(5.00)	-
Fixed Term Deposits	-	22.00	(17.00)	5.00
Total	**2.97**	**346.13**	**(334.98)**	**14.12**
Increase in investments				**11.15**

4.4. Interest received during the year was as follows:

Month	Average amount invested		Average rate of interest earned		Budget	Interest earned	(Surplus) /deficit
	Actual £m	Budget £m	Actual %	Budget %	£000	£000	£000
Apr-16	9.6	15	0.27	0.30	4	2	2
May-16	17.8	15	0.23	0.30	4	3	1
Jun-16	8.8	15	0.23	0.30	4	2	2
Jul-16	14.9	15	0.22	0.30	4	3	1
Aug-16	20.5	15	0.20	0.30	4	3	1
Sep-16	15.2	15	0.20	0.30	4	2	2
Oct-16	13.7	60	0.20	0.30	16	2	14
Nov-16	30.5	60	0.38	0.30	16	9	7
Dec-16	29.1	60	0.46	0.30	16	12	4
Jan-17	39.3	60	0.44	0.30	16	15	1
Feb-17	39.8	60	0.42	0.30	16	13	3
Mar-17	29.1	60	0.47	0.30	16	12	4
Outturn					**120**	**78**	**42**

4.5. The interest received in the year was below budget due to lower balances being maintained, reducing the need to borrow.

4.6. The average interest rate achieved during 2017/18 was 0.31%, slightly higher than budgeted. This compares favourably with the generally accepted benchmark of the average 7-day London Inter-Bank Bid (LIBID) rate of 0.21%.

4.7. In addition to interest earned on balances interest has been accrued in relation to the energy from waste plant loan to Mercia waste. This totalled £2.0m, the net loan position is set aside to fund increased waste disposal costs in future years.

5. Compliance with Prudential Indicators

5.1. The Council complied with its Prudential Indicators, Treasury Management Policy Statement and Treasury Management Practices for 2017/18 as detailed in Annex 1. A prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.

Annex 1

Performance Indicators

1. Treasury Management Indicators

The council measures and manages its exposures to treasury management risks using the following indicators.

1.1 Interest Rate Exposures

This indicator is set to control the council's exposure to interest rate risk. The indicator sets upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of net principal borrowed.

	2017/18 Approved Limit	**2017/18 maximum exposure**
Upper Limit for Fixed Rate Exposure	100%	100%
Upper Limit for Variable Rate Exposure	50%	15%

The above indicator relates to net debt, if the council has variable rate investments at the same level as its variable rate debt it is deemed to have no variable rate exposure (all council investments are regarded as being at variable rate because no investments are for more than one year).

1.2 Maturity Structure of Fixed Rate Borrowing

This indicator is to limit large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates.

Maturity Structure of Fixed Rate Borrowing	**Lower Limit %**	**Upper Limit %**	**Actual Fixed Rate Borrowing 31/03/18 £m**	**% Fixed Rate Borrowing 31/03/18**
Under 12 months	0%	35%	**5.54**	**4%**
12 months and within 24 months	0%	30%	**7.23**	**5%**
24 months and within 5 years	0%	25%	**12.38**	**9%**
5 years and within 10 years	0%	25%	**26.17**	**18%**
10 years and within 20 years	0%	40%	**28.70**	**20%**
20 years and within 30 years	0%	40%	**20.86**	**15%**
30 years and within 40 years	0%	40%	**22.17**	**15%**
40 years and within 50 years	0%	40%	**20.00**	**14%**
Total			**143.05**	**100%**

Two LOBO ("Lenders Option then Borrowers Option") bank loans of £6m each are repayable in 2054 however if the lenders seek to increase the interest rate charged, currently 4.50%, the council has the opportunity to repay the loans.

1.3 Upper Limit for Total Principal Sums Invested Over 364 Days

The purpose of this limit is to contain exposure to the possibility of financial loss that may arise as a result of the council having to seek early repayment of the sums invested.

Upper Limit for Total Principal Sums Invested Over 364 Days	2017/18 Approved £m	2017/18 Actual £m	2018/19 Estimate £m	2019/20 Estimate £m
Total	**5**	**0**	**5**	**5**

During 2017/18 no long-term investments were made for a period exceeding 364 days.

2. Prudential Indicators

2.1 Estimates of Capital Expenditure

This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits and, in particular, to consider the impact on council tax.

Capital Expenditure	2017/18		2018/19	2019/20
	Estimate £000	Actual £000	Estimate £000	Estimate £000
Total	**73,272**	**50,220**	**92,148**	**47,910**

Capital expenditure has been and is expected to be financed or funded as follows:

Capital Financing	2017/18		2018/19	2019/20
	Estimate £000	Actual £000	Estimate £000	Estimate £000
Capital grants	39,071	29,011	51,497	22,213
Capital receipts	9,745	4,184	12,495	150
Revenue funding	-	249	-	-
Prudential borrowing	24,456	16,776	28,156	25,547
Total	**73,272**	**50,220**	**92,148**	**47,910**

Generally prudential borrowing finance is provided where the return on the investment exceeds the debt financing cost.

3. Capital Financing Requirement (CFR)

Estimates of the council's cumulative maximum external borrowing requirement for 2017/18 to 2019/20 are shown in the table below:

Capital Financing Requirement	2017/18 Approved £000	2017/18 Actual £000	2018/19 Estimate £000	2019/20 Estimate £000
Total CFR	**290,123**	**314,628**	**307,307**	**328,395**

Total debt is expected to remain at or below the CFR during the forecast period.

4. Authorised Limit and Operational Boundary for External Debt

The Local Government Act 2003 requires the Council to set an Affordable Borrowing Limit or Authorised Limit. This is a statutory limit which should not be breached.

The Operational Boundary is based on the same estimates as the Authorised Limit but reflects the most likely, prudent but not worst case scenario without the additional headroom included within the Authorised Limit. The limits for other long term liabilities have been increased to £60m in the 2018/19 Treasury Management Strategy approved by Council in January 2018 to reflect the loan arrangement agreed in relation to the waste PFI arrangement.

	2017/18 Approved Operational Boundary £m	2017/18 Approved Authorised Limit £m	Actual External Debt as at 31/03/18 £m
Borrowing	310.0	320.0	148.0
Other Long-term Liabilities	30.0	40.0	55.4
Total	**340.0**	**360.0**	**203.4**

5. Ratio of Financing Costs to Net Revenue Stream

This is an indicator of affordability and 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 investment income.

Ratio of Financing Costs to Net Revenue Stream	2017/18 Approved %	2017/18 Actual %
Net Revenue Stream	145,025	145,026
Financing Costs	17,859	14,113
Percentage	**12.3%**	**9.7%**

6. Adoption of the CIPFA Treasury Management Code

This indicator demonstrates that the council has adopted the principles of best practice.

The council has incorporated the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition* into its treasury policies, procedures and practices. In December 2017 CIPFA revised the Treasury Management Code of Practice with full implementation expected in 2019/20.