Report to:	**Audit Committee**
Date:	**6 September 2018**
Title:	**Annual Treasury Management Report 2017/18**
Portfolio Area:	**Support Services – Councillor S Wright**
Wards Affected:	**ALL**

Urgent Decision:	**N**	Approval and clearance obtained:	**Y**

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Recommendations:

That the Audit Committee:

1. **Approves the actual 2017/18 prudential and treasury indicators in this report; and**
2. **Notes the Annual Treasury Management report for 2017/18.**

1. Executive summary

Income from investments this year was £140,126 which is £17,126 higher than the budget of £123,000 at an average return of 0.29%. The comparable performance indicator (Benchmark) is the average 7-day LIBID rate which was 0.21%. Therefore the Council achieved 0.08% return on investments over the benchmark for 17/18.

2. Background

Introduction

This 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).

Treasury management is defined as:

"The management of the local authority's cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks "

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 (Executive 09/03/17 – E73/16)
- A mid-year (minimum) treasury update report (Executive 07/12/17 – E47/17)
- An annual review following the end of the year describing the activity compared to the strategy (this report)

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.

This Council also 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. Member training on treasury management issues will be undertaken during 2018/19 in order to support members' scrutiny role.

The Economy and Interest Rates

During the calendar year of 2017, there was a major shift in expectations in financial markets in terms of how soon Bank Rate would start on a rising trend. After the UK economy surprised on the upside with strong growth in the second half of 2016, growth in 2017 was disappointingly weak in the first half of the year which meant that growth was the slowest for the first half of any year since 2012. The main reason for this was the sharp increase in inflation caused by the devaluation of sterling after the EU referendum, feeding increases into the cost of imports into the economy. This caused a reduction in consumer disposable income and spending power as inflation exceeded average wage increases. Consequently, the services sector of the economy, accounting for around 75% of GDP, saw weak growth as consumers responded by cutting back on their expenditure. However, growth did pick up modestly in the second half of 2017. Consequently, market expectations during the autumn, rose significantly that the MPC would be heading in the direction of imminently raising Bank Rate. The minutes of the MPC meeting of 14 September indicated that the MPC was likely to raise Bank Rate very soon. The 2 November MPC quarterly Inflation Report meeting duly delivered by raising Bank Rate from 0.25% to 0.50%. The 8 February MPC meeting minutes then revealed another sharp hardening in MPC warnings on a more imminent and faster pace of increases in Bank Rate than had previously been expected.
Market expectations for increases in Bank Rate, therefore, shifted considerably during the second half of 2017-18 and resulted in **investment rates** from 3 – 12 months increasing sharply during the spring quarter.

PWLB borrowing rates increased correspondingly to the above developments with the shorter term rates increasing more sharply than longer term rates. In addition, UK gilts have moved in a relatively narrow band this year, (within 25 bps for much of the year), compared to **US treasuries**. During the second half of the year, there was a noticeable trend in treasury yields being on a rising trend with the Fed raising rates by 0.25% in June, December and March, making six increases in all from the floor. The effect of these three increases was greater in shorter terms around 5 year, rather than longer term yields.

The **general election** on 8 June had relatively little impact on financial markets.

Overall Treasury Position as at 31 March 2018

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

Investments	31 March 2017 Principal	Return for 2016/17	31 March 2018 Principal	Return for 2017/18
	£	**%**	**£**	**%**
Short term - fixed	17,000,000	0.49	22,600,000	0.32
Money Market Funds	12,175,000	0.34	20,140,000	0.26
Heritable Bank	22,483	-	22,483	-
Total	**29,197,483**		**42,762,483**	

NOTE: The timing and complexities of schemes such as the Localisation of Business Rates Retention (retention of business rates growth above the baseline) can impact on the year end positions.

The following is a list of our investments at 31 March 2018.

Fixed Term Deposits

Counterparty	Fixed to	£	Interest Rate
Barclays Bank plc	03/05/2018	2,500,000	0.49%
Barclays Bank plc	19/09/2018	3,500,000	0.64%
Nationwide BS	06/04/2018	5,000,000	0.32%
Nationwide BS	19/06/2018	1,000,000	0.47%
Lloyds TSB Bank Plc	04/07/2018	5,000,000	0.60%
Lloyds TSB Bank Plc	02/08/2018	1,000,000	0.60%
Debt Management Office (See Note * below)	19/04/2018	1,600,000	0.25%
Debt Management Office (See Note * below)	19/04/2018	3,000,000	0.25%

*Note

These investments were taken out on 15th February and 15th March respectively (when the direct debit income from council tax and business rates was received) and were for a short term period. The current counter-party limits were already reached for Barclays, Nationwide and Lloyds. The investment was structured to mature on the day that the precepts were due to be paid to the major precepting authorities.

The Council's current counterparty limit is £6 million (£7 million for Lloyds plc).

Money Market Funds

Amount	Investment	Interest rate
£6,000,000	Standard Life (Ignis)	0.29%
£2,140,000	Deutsche	0.20%
£6,000,000	BlackRock	0.25%
£6,000,000	LGIM	0.28%

The Strategy for 2017/18

The expectation for interest rates within the treasury management strategy for 2017/18 anticipated that Bank Rate would remain at 0.50% until quarter 2 2019 and then increase to 0.75% in December 2018.

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. 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.

The Borrowing Requirement and Debt

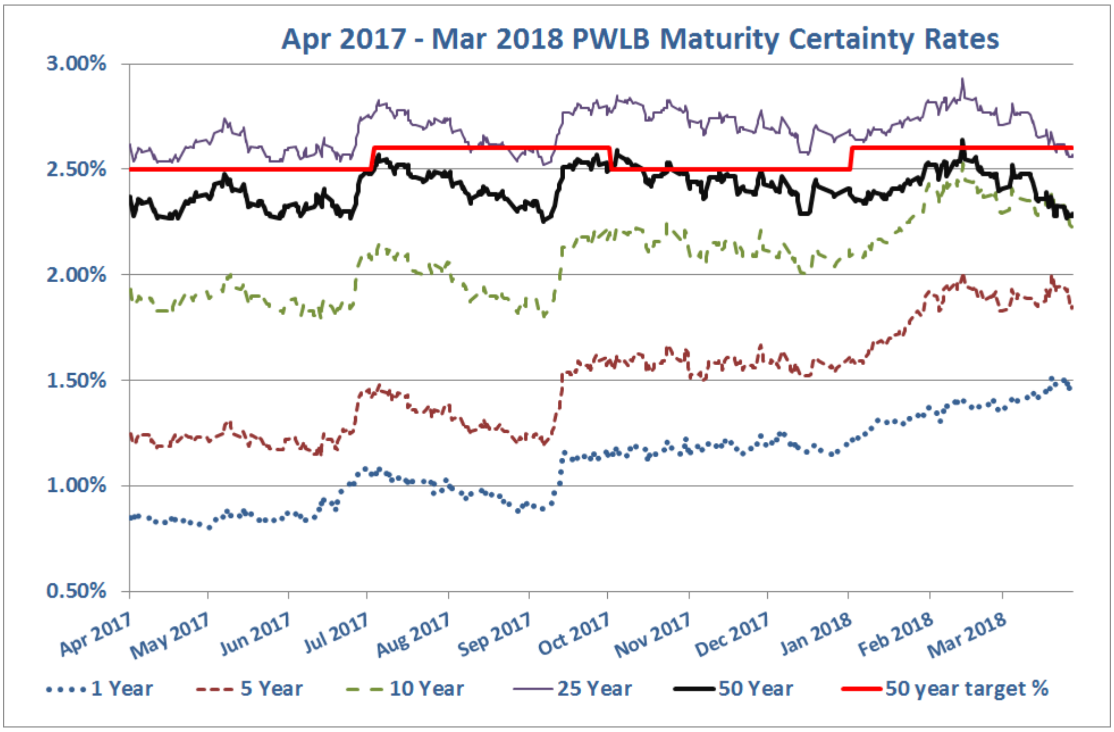
The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).

	31-Mar-17 Actual	31-Mar-18 Budget	31-Mar-18 Actual
CFR General Fund (£m)	-98	2,502	646

NOTE: The budgeted position of £2.5m included borrowing for Leisure Investment which happened after 31 March 2018. The cost of the Leisure Investment is being reimbursed to the Council by the Leisure contractor.

Borrowing Rates in 2017/18

PWLB borrowing rates - the graph below shows, for a selection of maturity periods, the average borrowing rates, the high and low points in rates, spreads and individual rates at the start and the end of the financial year.



Investment Rates in 2017/18

Investments rates for 3 months and longer have been on a rising trend during the second half of the year in the expectation of Bank Rate increasing from its floor of 0.25%, and reached a peak at the end of March. Bank Rate was duly raised from 0.25% to 0.50% on 2 November 2017 and remained at that level for the rest of the year.

Investment Outturn for 2017/18

Investment Policy – the Council's investment policy is governed by MHCLG guidance, which has been implemented in the annual investment strategy approved by the Council on 21 March 2017 (revised 5 December 2017 – CM46). This 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, (such as rating outlooks, credit default swaps, bank share prices etc.

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

Income from investments this year was £140,126 which is £17,126 higher than the budget of £123,000 at an average return of 0.29%. The comparable performance indicator (Benchmark) is the average 7-day LIBID rate which was 0.21%. Therefore the Council achieved 0.08% return on investments over the benchmark for 17/18.

Other Issues 2017/18

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 the Authority.

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 South Hams District Council apart from having to fill in forms sent by each institution dealing with the Authority and for each type of investment instrument we use, apart from for cash deposits with banks and building societies.

3. Implications

Implications	Relevant to proposals Y/N	Details and proposed measures to address
Legal/Governance	Y	Statutory powers are provided by the Local Government Act 1972 Section 151 and the Local Government Act 2003
Financial	Y	Income from Treasury Management activities amounted to £140,126 in 2017/18. Consideration of the Annual Treasury Report forms an essential component of the Council's systems for public accountability. It also provides a platform for future investment planning.
Risk	Y	The security risk is the risk of failure of a counterparty. The liquidity risk is that there are liquidity constraints that affect the interest rate performance. The yield risk is regarding the volatility of interest rates/inflation. The Council has adopted the CIPFA Code Of Practice for Treasury Management and produces an Annual Treasury Management Strategy and Investment Strategy in accordance with CIPFA guidelines. The Council engages a Treasury Management advisor and a prudent view is always taken regarding future interest rate movements. Investment interest income is reported quarterly to SLT and Members.
Comprehensive Impact Assessment Implications		
Equality and Diversity	N	N/a
Safeguarding	N	N/a
Community Safety, Crime and Disorder	N	N/a
Health, Safety and Wellbeing	N	N/a
Other implications	N	none

<u>Supporting Information</u>

Appendices:

Appendix A – Lending list as at 29 March 2018
Appendix B - Prudential and Treasury Indicators 2017/18

Background Papers:

Annual treasury strategy in advance of the year (Executive 09 March 2017 – E73/16)
A mid-year treasury update report (Executive 07 December 2017 – E47/17)

APPENDIX A

Counterparty as at 29th March		Fitch Rating						Moody's Ratings				S&P Ratings			
United Kingdom		Long Term		Short Term	Viability	Support		Long Term		Short Term		Long Term		Short Term	Suggested Duration
	Collateralised LA Deposit*														Y - 60 mths
	Debt Management Office														Y - 60 mths
	Multilateral Development Banks														Y - 60 mths
	Supranationals														Y - 60 mths
	UK Gilts														Y - 60 mths
Banks	Abbey National Treasury Services	SB	A	F1			1	SB	Aa3		P-1				R - 6 mths
	Bank of Scotland PLC	SB	A+	F1	a		5	SB	Aa3		P-1	PO	A	A-1	R - 6 mths
	Barclays Bank PLC	PW	A	F1	a		5	NW	A1		P-1	SB	A	A-1	R - 6 mths
	Close Brothers Ltd	SB	A	F1	a		5	SB	Aa3		P-1				R - 6 mths
	Goldman Sachs International Bank	SB	A	F1				NO	A1		P-1	SB	A+	A-1	R - 6 mths
	HSBC Bank PLC	SB	AA-	F1+	a+		1	NW	Aa3		P-1	SB	AA-	A-1+	O - 12 mths
	Lloyds Bank Plc	SB	A+	F1	a		5	SB	Aa3		P-1	PO	A	A-1	R - 6 mths
	Santander UK PLC	PW	A	F1	a		2	SB	Aa3		P-1	SB	A	A-1	R - 6 mths
	Standard Chartered Bank	SB	A+	F1	a		5	SB	A1		P-1	SB	A	A-1	R - 6 mths
	Sumitomo Mitsui Banking Corporation	SB	A	F1			1	SB	A1		P-1	SB	A	A-1	R - 6 mths
	UBS Ltd.	SB	AA-	F1+			1	SB	A1		P-1	SB	A+	A-1	O - 12 mths
Building Societies	Coventry Building Society	SB	A	F1	a		5	SB	A2		P-1				R - 6 mths
	Leeds Building Society	SB	A	F1	a-		5	SB	A3		P-2				G - 100 days
	Nationwide Building Society	SB	A+	F1	a		5	SB	Aa3		P-1	PO	A	A-1	R - 6 mths
	Skipton Building Society	SB	A-	F1	a-		5	SB	Baa1		P-2				G - 100 days
	Yorkshire Building Society	SB	A-	F1	a-		5	SB	A3		P-2				G - 100 days
Nationalised and Part Nationalised Banks	National Westminster Bank	PW	BBB+	F2	bbb+		5	PW	A2		P-1	PO	BBB+	A-2	B - 12 mths
	Royal Bank of Scotland Group Plc	SB	BBB+	F2	bbb+		5	SB	Baa3		P-3	SB	BBB-	A-3	B - 12 mths
	The Royal Bank of Scotland Plc	SB	BBB+	F2	bbb+	PW	5	NW	A2	NW	P-1	SB	BBB+	A-2	B - 12 mths

Key

Watches and Outlooks		Duration	
SB	Stable Outlook	Yellow - Y	60 Months
NO	Negative Outlook	Blue - B	12 Months
NW	Negative Watch	Orange - O	12 Months
PO	Positive Outlook	Red - R	6 Months
PW	Positive Watch	Green - G	100 Days
EO	Evolving Outlook		
EW	Evolving Watch		

APPENDIX B

<u>PRUDENTIAL AND TREASURY INDICATORS 2017/18</u>

The Council's capital expenditure plans are the key driver of treasury management activity. The outputs of the capital expenditure plans are reflected in prudential indicators, which are designed to assist members to overview and confirm capital expenditure plans.

Capital Expenditure

This prudential Indicator is a summary of the Council's capital expenditure.

Capital Expenditure	2016/17	2017/18	2017/18
	Actual £000	Estimate £000	Actual £000
Total	**3,023**	**5,015**	**4,179**

The table below summarises the financing of the Council's capital programme. Any shortfall of resources would result in a funding need (borrowing).

Capital Expenditure	2016/17	2017/18	2017/18
	Actual £000	Estimate £000	Actual £000
Total	**3,023**	**5,015**	**4,179**
Financed by:			
Capital receipts	665	877	1,212
Capital grants	1,166	613	1,079
Reserves	1,192	418	1,144
New Homes Bonus	0	507	0
Net financing need for the year	**0**	**2,600**	**744**

NB. Please note that the estimate for 2017-18 represents the approved capital programme for that year. However, actual capital spend includes not only expenditure on projects within that capital programme, but also expenditure on schemes carried forward from previous capital programmes.

NOTE: The estimate for 2017/18 included estimates for Leisure Investment which mostly happened after 31 March 2018. The cost of the Leisure Investment is being reimbursed to the Council by the Leisure contractor.

The Council's Borrowing Need (the Capital Financing Requirement)

The second prudential indicator is the Council's Capital Financing Requirement (CFR). It is essentially a measure of the Council's underlying need to borrow if the figure is greater than zero.

The Capital Financing Requirement estimate for 2017/18 was increased by £2.6 million in July 2016 (Minute 33/16) to reflect the new leisure contract. Note: No prudential borrowing occurred in 2017/18.

	2016/17	2017/18	2017/18
	Actual £000	**Estimate £000**	**Actual £000**
Total CFR	-98	2,502	646
Movement in CFR	Nil	2,600	744
Explained by:			
Minimum Revenue Provision	Nil	Nil	Nil
Change in underlying need to borrow	-	2,600	744

AFFORDABILITY PRUDENTIAL INDICATORS

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans.

These provide an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following indicators:

Ratio of financing costs to net revenue stream

This indicator identifies the trend in the receipt of net investment income against the net revenue stream. It is calculated by dividing investment income and interest received, by the Council's Net Budget Requirement.

	2016/17	2017/18	2017/18
	Actual	**Estimate**	**Actual**
Ratio of net financing cost to net revenue stream. This is a net cost.	(1.5)%	(0.5)%	(1.7)%

Estimates of the incremental impact of capital investment decisions on council tax

This indicator calculates the notional cost of the impact of lost investment income on the Council Tax, from spending capital resources.

The 2017/18 estimate of the impact on council tax (this is a notional indicator) included borrowing for Leisure Investment which happened after 31 March 2018. The cost of the Leisure Investment is being reimbursed to the Council by the Leisure contractor.

Incremental impact of capital investment decisions on the band D council tax (Notional cost as explained above)

	2016/17 Actual £	2017/18 Estimate £	2017/18 Actual £
Future incremental impact of capital investment decisions on the band D Council tax (Notional cost)	0.15	2.23	0.19

TREASURY INDICATORS: LIMITS TO BORROWING ACTIVITY

The Operational Boundary – This is the limit beyond which external debt is not normally expected to exceed. This is the maximum level of external debt for cash flow purposes.

Operational Boundary	2016/17 £	2017/18 £
Borrowing	2,000,000	5,000,000
Other long term liabilities	-	-
Total	2,000,000	5,000,000

The Authorised Limit for External Debt – A further key prudential indicator represents a control on the overall level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by Full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

This provides headroom over and above the operational boundary for unusual cash movements. This is the maximum amount of money that the Council could afford to borrow.

This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although no control has yet been exercised.

Authorised limit	**2016/17**	**2017/18**
	£	**£**
Borrowing	7,000,000	10,000,000
Other long term liabilities	-	-
Total	7,000,000	10,000,000

The Authorised Limit was increased in 2017/18 to reflect the proposed borrowing for the new leisure contract.