Full Council

13 November 2018

Report of: Service Director: Finance

Title: Treasury Management Annual Report 2017/18

Ward: City Wide

Member Presenting Report: Deputy Mayor – Finance, Governance and Performance

Recommendation

Council note the Annual Treasury Management Report for 2017/18, as detailed in Appendix A.

Summary

The Council is required to produce an annual treasury management review of activities and the actual treasury indicators in accordance with Local Government regulations.

The significant issues in the report are:

- The Council has complied with treasury management legislative and regulatory requirements during the period and all transactions were in accordance with the approved Treasury Management Strategy.

- The 2017-2022 Treasury Strategy identified a medium term borrowing requirement of £450m to support the existing and future Capital Programme. The Council's agreed policy is to defer borrowing while it has significant levels of cash balances (£64m at March 2018).

- The Council's long term debt at the 31 March 2018 was £431m with an average annual interest rate of 4.68%. Investments were £64m at the 31 March 2018 with an average annual interest rate of 0.44%.

Policy

There are no policy implications as a direct result of this report.

Consultation

1. Internal

Audit Committee, Strategic & Service Directors, and Deputy Mayor – Finance, Governance & Performance.

2. External

Link Asset Services – the Council's external treasury management advisors

Context

1. The Council's treasury management activity is underpinned by CIPFA's Code of Practice on Treasury Management (the Code), which requires local authorities to produce annually Prudential Indicators and a Treasury Management Strategy Statement on the likely financing and investment activity. The Code also requires reports to full Council mid-year and after the year end. The 2017/18 outturn report is set out as Appendix A.

2. The Code also requires the Council to nominate one of its Committees to have responsibility for scrutiny of its treasury management strategy, policy and activity. Council has delegated that responsibility to the Overview and Scrutiny Management Board and Audit Committee. Overall responsibility for treasury management remains with the Council. No treasury management activity is without risk; the effective identification and management of risk are integral to the Council's treasury management objectives.

3. Treasury management is defined as:

   "The management of the local authority's investments and 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.".

Proposal

Council note the Annual Treasury Management Report for 2017/18, as detailed in Appendix A.

Other Options Considered

Not applicable

Risk Assessment

The principal risks associated with treasury management are:

Risk	Mitigation
Loss of investments as a result of failure of counterparties	Limiting the types of investment instruments used, setting lending criteria for counterparties, and limiting the extent of exposure to individual counterparties
Increase in the net financing costs of the authority due to borrowing at high rates of interest / lending at low rates of interest	Planning and undertaking borrowing and lending in light of assessments of future interest rate movements, and by undertaking most long term borrowing at fixed rates of interest (to reduce the volatility of capital financing costs)

Public Sector Equality Duties

None necessary for this report

Legal and Resource Implications

Legal

The Council is under a duty to manage its resources prudently and therefore due consideration must always be given to its borrowing and lending strategy. A wide range of local authority financial activities, including borrowing, lending, financial management, and the approval of types of investment vehicle are governed by legislation and various regulations. The Council is obliged to comply with these.

(Legal advice provided by Quentin Baker – Interim Service Director: Legal and Democratic Services)

Financial
(a) Revenues
The financing costs arising from planned borrowing are provided for in the revenue budget and medium term financial plan. Any additional operating costs arising from capital investment must be contained within the revenue budget of the relevant department.

(b) Capital
Not Applicable
(Financial advice provided by Jon Clayton – Principal Accountant)

Land
Not applicable

Personnel
Not Applicable

Appendices:
Appendix A – Treasury Management Annual Report 2017/18

LOCAL GOVERNMENT (ACCESS TO INFORMATION) ACT 1985
Background Papers:

None

Appendix A

Treasury Management Annual Report 2017/18

Purpose of the report:

1. Under the CIPFA Code of Practice on Treasury Management (the Code) the Section 151 Officer is required to produce an outturn report on activities in the year to account for how the Strategy set at the start of the year has been implemented. This report meets the requirements of both the Code and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

Background

2. The Council's treasury management activity is underpinned by CIPFA's Code of Practice on Treasury Management (the Code), which requires local authorities to produce annually Prudential Indicators and a Treasury Management Strategy Statement on the likely financing and investment activity. The Code also requires reports to full Council mid-year and after the year end.

3. The Code also requires the Council to nominate one of its Committees to have responsibility for scrutiny of its treasury management strategy, policy and activity. Council has delegated this responsibility to the Overview and Scrutiny Management Board and Audit Committee. Overall responsibility for treasury management remains with the Council. No treasury management activity is without risk; the effective identification and management of risk are integral to the Council's treasury management objectives.

4. Treasury management is defined as:

   "The management of the local authority's borrowing, investments and 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."

The Economy and Interest Rates for 2017/18

5. **UK.** During the 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 with strong growth in the second half of 2016, growth in 2017 was weak in the first half of the year; quarter 1 came in at +0.3% (+1.7% y/y) and quarter 2 was +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. The main reason for this was the sharp increase in inflation caused by the devaluation of sterling after the EU referendum, increasing 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 in quarter 3 to 0.5% before dipping to 0.4% in quarter 4.

6. Consequently, market expectations during the autumn rose that the MPC would be heading in the direction of raising Bank Rate. The **MPC meeting of 14 September** provided a shock to the markets with a sharp increase in tone in the minutes where the MPC considerably hardened their wording in terms of a raise in Bank Rate very soon. The **2 November MPC quarterly Inflation Report meeting** delivered on this by withdrawing the 0.25% emergency rate cut which had been implemented in August 2016. Market debate then moved on as 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 2-3 years. The MPC minutes from that meeting were viewed as being dovish, i.e. there was now little pressure to raise rates by much over that time period. In particular, the GDP growth forecasts were weak while there was little evidence of pressure on wage increases despite the low unemployment. The MPC forecast that CPI would peak at about 3.1% and chose to look through that breaching of its 2% target as this was a one off result of the devaluation of sterling caused by the result of the EU referendum. The inflation forecast showed that the MPC expected inflation to come down to near the 2% target over the two to three year time horizon meaning cooling expectations of further action to raise Bank Rate over the next two years.

7. 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. The **8 February MPC meeting** minutes therefore revealed another sharp hardening in MPC warnings focusing on a reduction in spare capacity in the economy, weak increases in productivity, higher GDP growth forecasts and a shift of their time horizon to focus on the 18 – 24 month period for seeing inflation come down to 2%. (CPI inflation ended the year at 2.7% but was forecast to still be just over 2% within two years.) This resulted in an increase in expectations that there would be another Bank Rate in 2018 and a bringing forward of the timing of subsequent increases in Bank Rate. This shift in expectations resulted in **investment rates** from 3 – 12 months increasing sharply during the spring quarter.

8. **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 basis points for much of the year), compared to **US**. 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. The effect of these increases was greater in shorter terms around 5 year, rather than longer term yields.

9. **Equity markets**, the FTSE 100 hit a new peak near to 7,800 in early January before there was a sharp sell-off in a number of stages during the spring, replicating similar developments in US equity markets.

10. The major UK landmark event of the year was the inconclusive result of the **general election** on 8 June. However, this had relatively little impact on financial markets. However, **sterling** did suffer a sharp devaluation 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 this has been progressing.

11. **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.

12. **EU.** Economic growth in the EU, (the UK's biggest trading partner), was lack lustre for several years after the financial crisis despite the ECB eventually cutting its main rate to -0.4% and embarking on a massive programme of quantitative easing to stimulate growth. However, growth eventually picked 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.

13. **USA.** Growth in the American economy was volatile in 2015 and 2016. 2017 followed that path again with quarter 1 at 1.2%, quarter 2 3.1%, quarter 3 3.2% and quarter 4 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. 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 – 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, consequently increasing 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.

14. **Chinese economic growth** has been weakening over successive years, despite repeated rounds of central bank stimulus and medium term risks are increasing. 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.

Treasury position as at 31 March 2018

15. The table below indicates the balance of borrowing and investments at the beginning and end of the year and average borrowing cost and investment returns for each period:

	31 March 2017		**31 March 2018**	
	£m	**Average Rate %**	**£m**	**Average Rate %**
Long Term Debt (fixed rates) - PWLB	311	5.09	311	4.92
Long Term Debt (fixed rates) – LOBOS	100	4.11	100	4.11
Long Term Debt (fixed rates) – Market	23	4.24	20	3.84
Short Term Borrowing	-	-	-	-
Total borrowing	**434**	**4.81**	**431**	**4.68**
Investments	70	0.57	64	0.44
Net Borrowing Position	**364**		**367**	

16. The total borrowing excludes accrued interest of £5m (£5m at 31/3/17) and the outstanding finance on PFI and service contracts of £140m at 31 March 2018 (£146m at 31/3/17).

17. The authority also has long term service investments costing £36m primarily relating to the holdings in Bristol Holdings Company (£23m), Bristol Port Company (£3m) and a property fund to support Homelessness (£10m).

18. The Net debt has increased by £3m from £364m to £367m primarily due to;
    - Funding of the capital programme financed by borrowing +£44m
    - Net increase of reserves (£55m)
    - Other changes to working capital / provisions +£14m

Long Term Borrowing – Strategy and outturn

19. The 2017–2022 Treasury Strategy (approved 21st February 2017) identified a medium term borrowing requirement of £450m to support the existing and future Capital Programme with the debt servicing costs predominately met from revenue savings from capital investment and the economic development fund. The £450m was planned to be borrowed in the following periods, 17/18 - £130m, 18/19 - £140m, 19/20 - £90m, 20/21, £50m and 21/22 - £40m.

20. The Council's Strategy is also to defer borrowing while it has significant levels of liquid treasury investments, £64m at March 2018 (£70m at March 2017). Deferring borrowing will reduce the "net" revenue interest cost of the Authority as well as reducing the Councils exposure to counter party risk for its investments. The Council recognises that utilising investments in lieu of borrowing clearly has a finite duration and that future borrowing will be required to support capital expenditure (see 2017/18 Treasury Management Strategy approved by Council 21st February 2017).

    https://democracy.bristol.gov.uk/documents/s11926/Appendix%204%20Treasury%20Management%20Strategy%20201718.pdf

21. Borrowing activity in year was in accordance with the Strategy approved at the beginning of the year**:**

    - **Borrowing** – No borrowing was undertaken as the authority maintained higher levels of investments than originally anticipated for a variety of reasons including the time taken to progress capital schemes where the source of financing is external borrowing.

    - **Rescheduling –** No debt rescheduling activity was undertaken in 2017/18. As set out in the Treasury Mid-Year report the total life cycle cost of rescheduling loans on a discounted cash-flow basis has been reviewed with no loans providing a positive cash-flow benefit to the authority. This would in part be due to large early repayment penalties that the authority will incur, circa £253m penalty to repay the PWLB loans (£311m) early as at 31st March 2018.

Annual Investment Strategy and Outturn

22. Investment rates for 3 months and longer have been on a rising trend during the second half of the year in the expectation of Bank Rate increasing from its floor of 0.25%.

23. Bank Rate was raised from 0.25% to 0.50% on the 2nd November 2017 and remained at that level for the rest of the year, with further increases expected over the next few years. Deposit rates continued into the start of 2017/18 at previous depressed levels due, in part, to a large tranche of cheap financing being made available under the Term Funding Scheme to the banking sector by the Bank of England; this facility ended on the 28th of February 2018.

24. Security of capital remained the Council's main investment objective. This was maintained by following the Council's policy for assessing institutions to which the council might lend. 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.).

25. Investments held by the Council - the Council maintained an average balance of £94m (£146m 2016/17) of internally managed funds. The internally managed funds received an average return of 0.44% (0.57% 2016/17). The comparable performance indicator is the average 7-day LIBID rate, which was 0.22%.

Compliance with Treasury Limits and Treasury Related Prudential Indicators

26. The Council can confirm that:

- All treasury related transactions were undertaken by authorised officers and within the limits and parameters approved by the Council;
- All investments were to counterparties on the approved lending list
- The Council operated within the Prudential Indicators within Appendix 1.

Performance Indicators set for 2017/18

27. One of the key requirements in the Code is the formal introduction of performance measurement relating to investments, debt, and capital financing activities. Whilst investment performance criteria have been well developed and universally accepted, debt performance indicators continue to be a more problematic area with the traditional average portfolio rate of interest acting as the main guide. The Council's performance indicators were set out in the Annual Treasury Management Strategy.

28. The following performance indicators have been set:
    - Debt – Average rate movement, noting no borrowing undertaken during the year.
    - Investments – Internal returns above the 7 day LIBID rate
    - Average rate for the year 0.44% vs. annual average 7 day LIBID of 0.22%

Consultation and scrutiny input

29. The report has been discussed with the Council's external treasury management advisers and internally with Strategic & Service Directors, and Deputy Mayor – Finance, Governance & Performance.

Risk Assessment

30. The principal risks associated with treasury management are:

Risk	Mitigation
Loss of investments as a result of failure of counterparties	Limiting the types of investment instruments used, setting lending criteria for counterparties, and limiting the extent of exposure to individual counterparties
Increase in the net financing costs of the authority due to borrowing at high rates of interest / lending at low rates of interest	Planning and undertaking borrowing and lending in light of assessments of future interest rate movements, and by undertaking most long term borrowing at fixed rates of interest (to reduce the volatility of capital financing costs)

Public sector equality duties:

31. There are no proposals in this report, which require either a statement as to the relevance of public sector equality duties or an Equalities Impact Assessment.

Environmental checklist / eco impact assessment

32. There are no proposals in this report which have environmental impacts

Legal and Resource Implications

33. Legal- the Council is under a duty to manage its resources prudently and therefore due consideration must always be given to its borrowing and lending strategy. A wide range of local authority financial activities, including borrowing, lending, financial management, and the approval of types of investment vehicle are governed by legislation and various regulations. The Council is obliged to comply with these.

    Advice provided by Quentin Baker (Interim Service Director: Legal and Democratic Services)

Financial

(a) Revenue

34. The financing costs arising from planned borrowing are provided for in the revenue budget and medium term financial plan.

Advice given by Jon Clayton (Principal Accountant)

(b) Capital

35. There is no direct capital investment implications contained within this report.

Land

36. There are no direct implications for this report.

Personnel

37. There are no direct implications for this report.

Appendices:

Appendix 1: Treasury Management Annual Report 2017/18

LOCAL GOVERNMENT (ACCESS TO INFORMATION) ACT 1985

Background Papers:

38. Treasury Management Strategy 2017/18

https://democracy.bristol.gov.uk/documents/s11926/Appendix%204%20Treasury%20Management%20Strategy%20201718.pdf

Appendix 1

Annual Report on the Treasury Management Service 2017/18 (Incorporating Outturn Prudential Indicators)

Introduction

1. This report summarises:

    - The capital activity during the year
    - What resources the Council applied to pay for this activity;
    - The impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement);
    - The reporting of the required prudential indicators;
    - Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances;
    - A summary of interest rate movements in the year;
    - The detailed debt activity;
    - The detailed investment activity;
    - Local Issues

The Council's Capital Expenditure and Financing 2017/18

2. The Council undertakes capital expenditure to invest in the acquisition and enhancement of long-term assets. These activities may either be:

    - Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or

    - If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

3. The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

	2016/17 Actual £m	**2017/18 Original Budget £m**	**2017/18 P10 - Final Budget £m**	**2017/18 Actual £m**
Non-HRA capital expenditure	147	173	114	104
HRA capital expenditure	49	41	34	32
Total capital expenditure	**196**	**214**	**146**	**136**
Resourced by:				
Capital receipts	15	3	5	6
Capital grants	62	39	40	45
HRA Self Financing	34	25	25	24
Prudential borrowing	67	130	59	44
Revenue	18	17	17	17
Total Resources	**196**	**214**	**146**	**136**

The Council's Overall Borrowing Need

4. The Council's underlying need to borrow is called the Capital Financing Requirement (CFR). This figure is a gauge of the Council's debt position. It represents 2017/18 and prior years' net capital expenditure that has not yet been paid for by revenue or other resources.

5. Part of the Council's treasury activities is to address this borrowing need, either through borrowing from external bodies, or utilising temporary cash resources within the Council.

6. Reducing the CFR – Whilst under treasury management arrangements actual debt can be borrowed or repaid at any time within the confines of the annual treasury strategy, the Council is required to make an annual revenue charge to reduce the CFR – effectively a repayment of the Non-Housing Revenue Account (HRA) borrowing need. There is no statutory requirement to reduce the HRA CFR.

7. This statutory revenue charge is called the Minimum Revenue Provision - MRP. The total CFR can also be reduced by:

   - the application of additional capital resources (such as unapplied capital receipts); or
   - charging more than the statutory revenue charge (MRP) each year through a Voluntary

Revenue Provision (VRP).

8. The Council's 2017/18 MRP Policy (as required by CLG Guidance) was approved on the 17th February 2017.

9. The Council's CFR for the year is shown below, and represents a key prudential indicator. Accounting rule changes in previous years has meant that PFI schemes are now included on the balance sheet, which increases the Council's borrowing need, the CFR. No borrowing is actually required against these schemes as a borrowing facility is included in the contract.

CFR	General Fund 31 March 2017 Actual £m	General Fund 31 March 2018 Actual £m	HRA 31 March 2017 Actual £m	HRA 31 March 2018 Actual £m	Total CFR 31 March 2018 Actual £m
Opening balance	**489**	**543**	**245**	**245**	**788**
Add unfinanced capital expenditure (as above)	67	44	-	-	44
Less MRP/VRP	(8)	(3)	-	-	(3)
Less PFI & finance lease repayments	(5)	(6)	-	-	(6)
Closing balance	**543**	**578**	**245**	**245**	**823**

Treasury Position at 31 March 2018

10. Whilst the Council's gauge of its underlying need to borrow is the CFR, Finance can manage the Council's actual borrowing position by either:

- Borrowing to the CFR; or
- Choosing to utilise some temporary internal cash flow funds in lieu of borrowing or
- Borrowing for future increases in the CFR (borrowing in advance of need).

11. The figures in this report are based on the principal amounts borrowed and invested and so may differ from those in the final accounts by items such as accrued interest.

	31 March 2017		31 March 2018	
	Principal £m	**Average Rate %[2]**	**Principal £m**	**Average Rate %[2]**
Fixed Interest Rate Debt	311	5.09	311	4.92
Variable Interest Rate Debt	-	-	-	-
Market Debt – LOBO[1]	100	4.11	100	4.11
Market Debt	23	4.24	20	3.84
PFI / Service Contracts	146	-	140	-
Total Debt	**580**	**4.81**	**571**	**4.68**
Debt administered of behalf of Unitary Authorities (Ex Avon Debt)	(46)	-	(44)	-
Revised Debt	534	4.81	527	4.68
Capital Financing Requirement	788		823	
Over/(Under) borrowing	(254)		(296)	
Investment position				
Investments (Fixed & Call)	70	0.57	64	0.44
Net borrowing position (excl leasing arrangements)	**364**	**-**	**367**	**-**

1 Lender option Borrower option, 2 reflects the average rate for the year taking account of new loans and repayments.

12. The fixed Interest rate debt is apportioned between the General Fund and HRA as set out in the table below.

Fixed Interest Rate Debt	**31 March 2017 £m**		**31 March 2018 £m**	
	Principal £m	**Average Rate%**	**Principal £m**	**Average Rate%**
General Fund	194	4.96	193	4.68
HRA	240	4.69	238	4.68
Total	434	4.81	431	4.68

13. The maturity structure of the debt portfolio (excluding accrued interest) was as follows:

	Approved Min Limit%	**Approved Max Limit%**	**31 March 2017**		**31 March 2018**	
			Actual £m	**%**	**Actual £m**	**%**
Under 12 Months	0	20	3	1	-	-
1 to 2 years	0	20	-	-	-	-
2 to 5 years	0	40	10	2	15	3
5 to 10 years	0	40	37	9	49	11
10 years and over	25	100	384	88	367	86
Total			**434**	**100**	**431**	**100**

14. The Council hold £100m of LOBOS with maturities averaging 50 years. Inherent within these loan instruments are options (averaging an option every 4 years) that could give rise to the debt being repaid early. These loans are regularly reviewed with the current and expected structure of interest rates. The risk of the lenders exercising their options is currently low for the short to medium term. Therefore, the maturity of these loans in above table is based on their maturity date, 10 years and over.

15. The Council will continually review these loans in accordance with economic forecasts and will update the maturity structure of the debt portfolio accordingly and assess the future re-financing risks exposed to the authority and report any changes within future monitoring reports.

16. The authority's borrowing strategy is to delay borrowing and use its existing resources to support the Capital Programme to reduce its exposure to counterparty risk and the net interest cost of the authority. The authority, as planned, did not undertake further borrowing while the authority maintained higher levels of investments than originally anticipated. This was due to a variety of reasons including the time taken to progress capital schemes where the source of financing was external borrowing.

17. If it had been felt that there was a significant risk of a much sharper RISE in long and short term rates than expected, perhaps arising from an acceleration in bank rate, an increase in world economic activity or a sudden increase in inflation risks, then this course of action would have been re-appraised. Most likely, fixed rate funding would have been drawn whilst interest rates were lower than they were projected to be over the short to medium term.

Prudential Indicators and Compliance Issues

18. Some of the prudential indicators provide either an overview or specific limits on treasury activity. These are shown below:

19. **Gross Borrowing and the CFR** - In order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement over the medium term. This essentially means that the Council is not borrowing to support revenue expenditure. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

	31 March 2017 Actual £m	**31 March 2018 Actual £m**
Gross borrowing position	434	431
CFR (excluding PFI)	642	683

20. **The Authorised Limit** - The Authorised Limit is the "Affordable Borrowing Limit" required by Section 3 of the Local Government Act 2003. Once agreed the authorised limit cannot be breached. The Council does not have the power to borrow above this level. The table below demonstrates that during 2017/18 the Council has maintained gross borrowing within its

Authorised Limit.

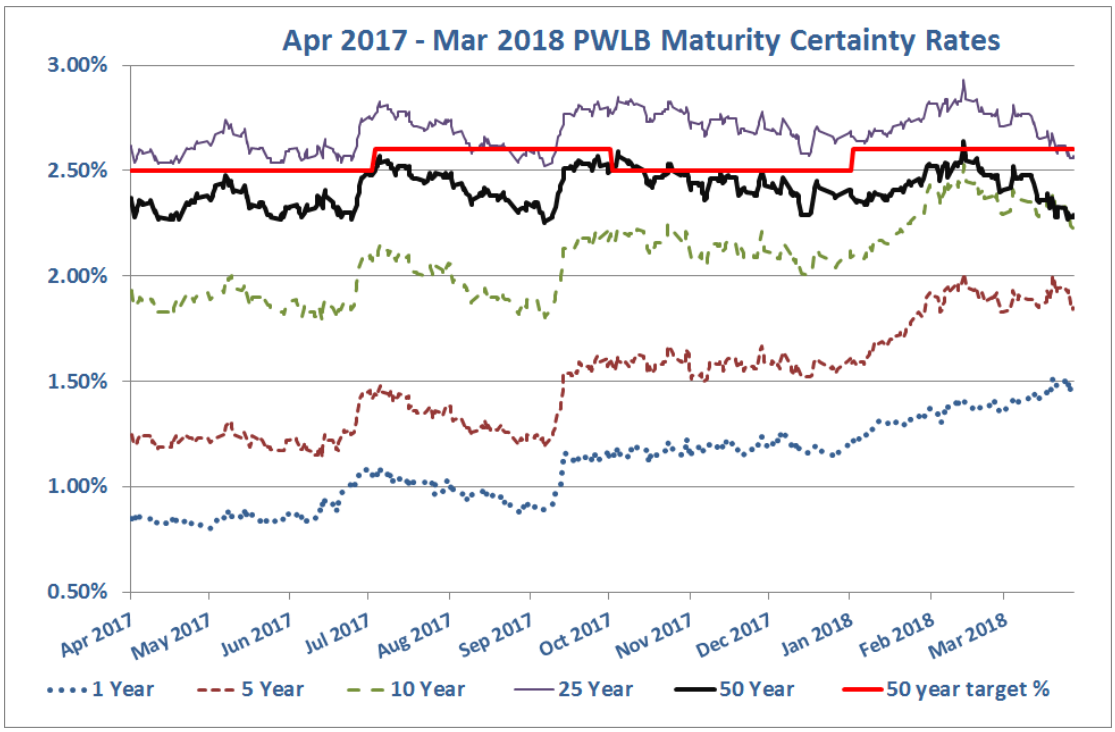
21. **The Operational Boundary** – The Operational Boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the Boundary is acceptable subject to the Authorised Limit not being breached.

22. **Actual financing costs as a proportion of net revenue stream** - This indicator identifies the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

	2017/18 £m
Authorised Limit	900
Operational Boundary	683
Average gross borrowing position (including PFI)	575
Financing costs as a proportion of net revenue stream: General Fund HRA	 6.35% 8.80%

Borrowing Rates in 2017/18

23. PWLB borrowing rates - the graph below shows how PWLB certainty rates have fluctuated throughout the year. The PWLB 25 and 50 year rates have been volatile during the year with little consistent trend, while the shorter rates were on a rising trend during the second half of the year and reached peaks in February / March.



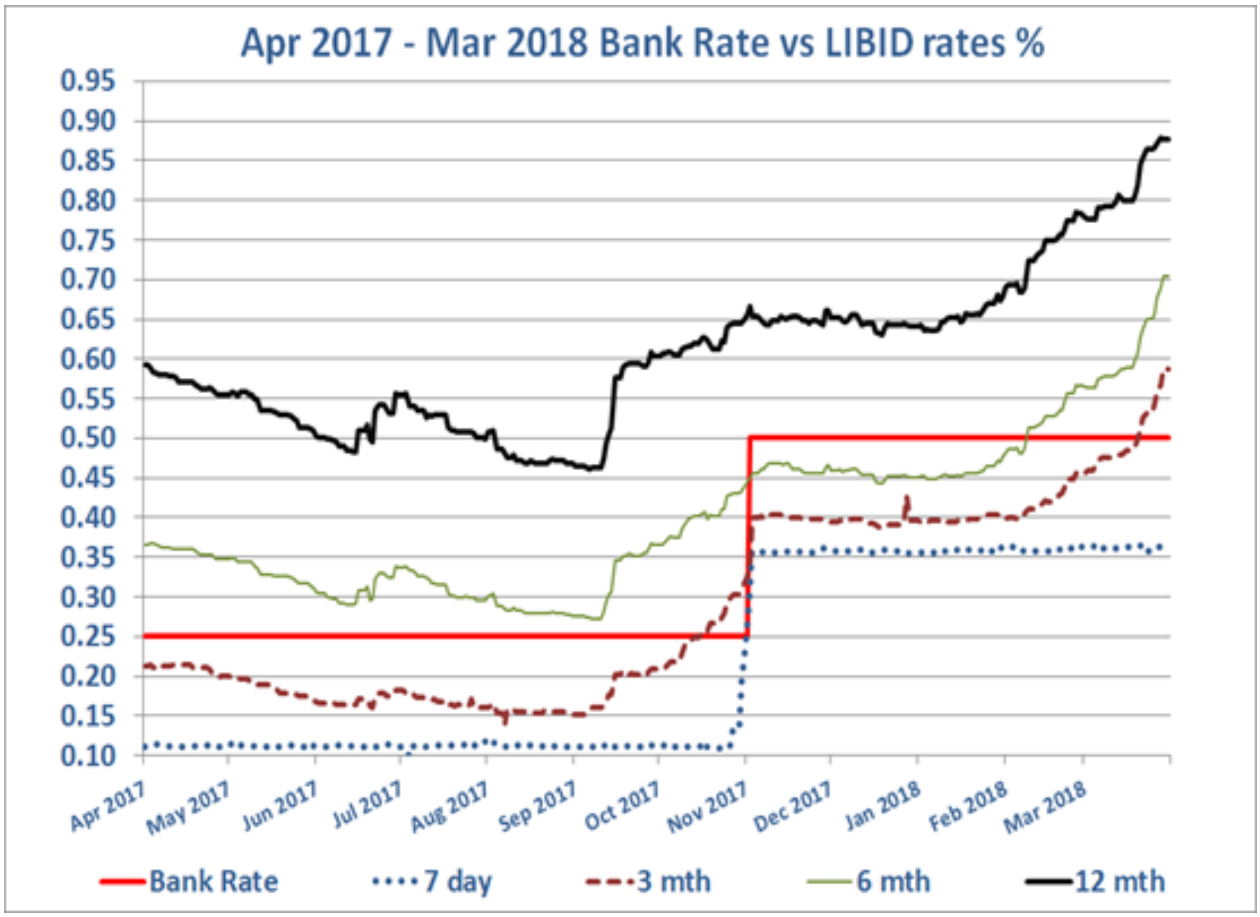
24. **Summary of Debt Transactions –** No long term borrowing was undertaken during year as mentioned previously within the report.

25. The average rate of interest for the debt portfolio is 4.68%.

Investment Rates in 2017/18

26. Investment rates for 3 months and longer have been on a rising trend during the second half of the year in the expectation of Bank Rate increasing from its floor of 0.25%, and reached a peak at the end of March.

    Bank Rate was duly raised from 0.25% to 0.50% on the 2nd of November 2017 and remained at that level for the rest of the year. However, further increases are expected over the next few years. Deposit rates continued into the start of 2017/18 at previous depressed levels due, in part, to a large tranche of cheap financing being made available under the Term Funding Scheme to the banking sector by the Bank of England; this facility ended on the 28th February 2018.



27. The Council's investment policy is governed by CLG guidance, which has been implemented in the annual investment strategy approved by the Council on 21st February 2017. 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.

Local Issues

28. **Ethical Investment Policy-** The "Ethical Investment Policy" was approved by Cabinet on 15th December 2011 (updated February 2015). There are no breaches to report.

Regulatory Framework, Risk and Performance

29. The Council's treasury management activities are regulated by a variety of professional codes and statutes and guidance:

    - The Local Government Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;
    - The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions have been made);
    - Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act;
    - The SI requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities;
    - The SI also requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services;
    - Under the Act the CLG has issued Investment Guidance to structure and regulate the Council's investment activities.
    - Under section 238(2) of the Local Government and Public Involvement in Health Act 2007 the Secretary of State has taken powers to issue guidance on accounting practices. Guidance on Minimum Revenue Provision was issued under this section on 8th November 2007.

30. The Council has complied with all of the above relevant statutory and regulatory requirements which require the Council to identify and, where possible, quantify the levels of risk associated with its treasury management activities. In particular its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach.

31. The Council has ensured that the principles of security, liquidity and yield have been adhered to within the treasury operation. This implies that the safeguarding of the principal investment with a suitable counterparty remains the Council's highest priority followed by liquidity (i.e. ease of access to the principal amount deposited) and yield (i.e. return) on investment.

Revised Cipfa Codes

32. 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.

33. A particular focus of these revised codes was how to deal with local authority investments which are not treasury type investments. The outcome being that local authorities will 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 this new report, "Capital Strategy" during 2018/19.

Markets in Financial Instruments Directive II (MiFID II)

34. The EU set the date of 3 January 2018 for the introduction of regulations under MIFID II. These regulations govern the relationship that financial institutions conducting lending and borrowing transactions will have with local authorities from that date. This has had little effect on this Authority apart from having to fill in forms sent by each institution dealing with this Authority and for each type of investment instrument we use, apart from for cash deposits with banks and building societies.

35. The EU set the date of 3 January 2018 for the introduction of regulations under MIFID II. These regulations govern the relationship that financial institutions conducting lending and borrowing transactions will have with local authorities from that date. This has had little effect on this authority apart from the completion on annual forms sent by each institution dealing with this authority and for each type of investment instrument that we currently use apart from standard cash deposits with banks and building societies.