

SOUTH HOLLAND DISTRICT COUNCIL

Report of: Executive Director Commercialisation (S151), Christine Marshall

To: Governance and Audit Committee 24 May 2018
Council 11 July 2018

Author: Sean Howsam – Finance Manager – Treasury (CPBS)

Subject: Annual Treasury Management Review 2017/18

Purpose: To consider the Annual Treasury Management Review for 2017-18 prior to it being submitted to Council for approval.

Recommendation(s):

- 1) That the Governance and Audit Committee scrutinise the Annual Treasury Management Review 2017/18 and make any comments for consideration by Council when they consider this document for approval at their meeting on 11 July 2018.

1.0 BACKGROUND

1.1 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).

During 2017/18 the following reports have been submitted:

- an annual treasury strategy in advance of the year (Council 22/02/2017);
- a mid year (minimum) treasury update report (submitted to Governance and Audit 14/12/2017);
- An annual review following the end of the year describing the activity compared to the strategy (this report).

1.2 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.

1.3 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 and Governance Committee. Member training on treasury management issues was undertaken during 2017/18 on 15/03/2018 in order to support the members' scrutiny role.

1.4 The Treasury Management function is administered by Compass Point Business Services on behalf of the Council.

2.0 INTRODUCTION

2.1 This report summarises the following :-

- Capital activity during the year;
- Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement);
- The actual prudential and treasury indicators;
- Overall treasury position identifying how the Council has borrowed in relation to its indebtedness, and the impact on investment balances;
- Summary of interest rate movements in the year;
- Detailed debt activity; and
- Detailed investment activity.

3.0 THE COUNCIL'S CAPITAL EXPENDITURE AND FINANCING 2017/18

3.1 The Council undertakes capital expenditure on 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.

3.2 The actual capital expenditure forms one of the required prudential indicators. The following tables show the actual capital expenditure and how this was financed.

£'000 General Fund	2016/17 Actual	2017/18 Estimate	2017/18 Actual
Capital expenditure	1,924	4,065	2,606
Financed in year	(638)	(2,357)	(1,486)
Unfinanced capital expenditure	1,286	1,708	1,120

£'000 Housing Revenue Account (HRA)	2016/17 Actual	2017/18 Estimate	2017/18 Actual
Capital expenditure	3,052	9,220	3,369
Financed in year	(3,052)	(9,220)	(3,369)
Unfinanced capital expenditure	-	-	-

4.0 THE COUNCIL'S OVERALL BORROWING NEED

- 4.1 The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's indebtedness. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represents the 2017/18 unfinanced capital expenditure (see above table), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.
- 4.2 Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the Government, through the Public Works Loan Board (PWLB) or the money markets), or utilising temporary cash resources within the Council.
- 4.3 Reducing the CFR – the Council's (non HRA) underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision (MRP), to reduce the CFR. This is effectively a repayment of the non-HRA borrowing need (there is no statutory requirement to reduce the HRA CFR). This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

The total CFR can also be reduced by:

- the application of additional capital financing resources (such as unapplied capital receipts); or
 - charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).
- 4.4 The Council's 2017/18 MRP Policy as required by Ministry of Housing, Communities and Local Government (MHCLG) guidance was approved as part of the Treasury Management Strategy Report for 2017/18 on 22/02/2017 and amended at Full Council on 17/01/2018.
- 4.5 The Council's CFR for the year is shown below, and represents a key prudential indicator:

CFR (£'000): General Fund	31 March 2017 Actual	31 March 2018 Budget	31 March 2018 Actual
Opening Balance	308	2,557	2,557
Add unfinanced capital expenditure (as above)	1,286	1,708	1,120
Add Transfer of Land & Buildings From HRA	963	-	170
Closing Balance	2,557	4,265	3,847

CFR (£'000): HRA	31 March 2017 Actual	31 March 2018 Budget	31 March 2018 Actual
Opening Balance	69,584	68,609	68,609
Add unfinanced capital expenditure (as above)	-	-	-
Less MRP/VRP and other financing movements	(12)	-	-
Less Transfer of Land & Buildings to General Fund	(963)	-	(170)
Closing Balance	68,609	68,609	68,439

Borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit.

- 4.6 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 CFR in the preceding year (2016/17) plus the estimates of any additional CFR for the current (2017/18) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs in 2017/18. 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 (£'000)	31 March 2018 Budget (£'000)	31 March 2018 Actual (£'000)
Gross Borrowing Position	67,456	67,456	67,456
CFR	71,166	72,874	72,286

- 4.7 The authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level. The following table demonstrates that during 2017/18 the Council has maintained gross borrowing within its authorised limit.

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.

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

	2017/18
Authorised limit	£90.456m
Maximum gross borrowing position	£67.456m
Operational boundary	£80.360m
Average gross borrowing position	£67.456m
Financing costs as a proportion of net revenue stream – Non HRA HRA	-1.53% 34.12%

5.0 TREASURY POSITION AS AT 31 MARCH 2018

5.1 The Council's debt and investment position is organised by the treasury management service in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through member reporting and through officer activity detailed in the Council's Treasury Management Practices. At the beginning and the end of 2017/18 the Council's treasury position including accrued interest was as follows:

	31/3/17 Amount £'000	Rate/ Return %	Average Life	31/3/18 Amount £'000	Rate/ Return %	Average Life
Fixed rate funding						
PWLB	67,456	3.48	45 years	67,456	3.48	44 years
Leases	-	n/a		-	n/a	
Total debt	67,456	3.48	45 years	67,456	3.48	44 years
CFR	71,166			72,286		
Over/(under) borrowing	(3,710)			(4,830)		
Cash and investments:						
long term	(927)	n/a	n/a	(927)	n/a	n/a
short term	(29,290)	0.60	99 days	(32,597)	0.76	155 days
instant access deposits	(4,908)	0.23	1 day	(3,115)	0.46	1 day
Total cash and investments	(35,125)	0.55	84 days	(36,639)	0.73	141 days
Net debt	32,331			30,817		

5.2 Investments held at 31 March 2018 including accrued interest were as follows:

Financial Institution (Lowest long term rating in brackets)	Investment Type	Amount £'000	Start Date	Maturity Date	Rate/Return %
UK Municipal Bonds Agency	Equity	50	n/a	n/a	n/a
Welland Homes Ltd (N/A)	Equity	877	n/a	n/a	n/a
Svenska Handelsbanken (AA-)	Instant Access	513	n/a	n/a	0.43
CCLA Money Market Fund (AAA)	Money Market Fund	2,602	n/a	n/a	0.46
Royal Bank of Scotland (BBB+)	Certificate of Deposit	5,034	13/04/17	13/04/18	0.70
Qatar National Bank (A)	Time Deposit	1,008	18/04/17	18/04/18	0.83
Coventry Building Society (A)	Time Deposit	4,009	03/11/17	03/05/18	0.54
Telford & Wrekin Council (AA)	Time Deposit	3,001	19/03/18	21/05/18	0.85
First Abu Dhabi Bank (AA-)	Time Deposit	5,025	01/06/17	01/06/18	0.60
Lloyds Bank (A)	Time Deposit	2,508	21/11/17	20/11/18	0.90
London Borough of Enfield (AA)	Time Deposit	5,006	02/02/18	01/02/19	0.78
Oadby & Wigston Borough Council (AA)	Time Deposit	3,003	14/02/18	13/02/19	0.78
Cambridgeshire County Council (AA)	Time Deposit	4,003	28/02/18	27/02/19	1.00
TOTAL		36,639			

In addition to the above investments, the Council has issued two loans to Welland Homes which are classified as Long Term Debtors. The balance and details of these loans as at 31 March 2018 are as follows:

Loan 1 - £1,341,642.80 @ 3.5% repayable on 17/03/47.

Loan 2 - £187,675.67 @ 5.5%. This is a development loan and once the development has been completed the rate reduces to 3.5% in accordance with the loan agreement.

5.3 As at 31 March 2018 the maturity structure of the investment portfolio was all under one year with the exception of the £50k equity stake in the UK Municipal Bonds Agency and the £2.4m combined equity stake in, and loans to Welland Homes Ltd.

5.4 All borrowing is at fixed rates and cash/investment holdings are split £33.5m fixed and £3.1m variable. The whole of the borrowing is due for repayment on 28 March 2062.

6.0 THE STRATEGY FOR 2017/18

6.1 The expectation for interest rates within the treasury management strategy for 2017/18 anticipated that Bank Rate would not start rising from 0.25% until quarter 2 2019 and then only increase once more before 31/03/20. 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. 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.

6.2 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.

6.3 During 2017/18, longer term PWLB rates were volatile but with little overall direction, whereas shorter term PWLB rates were on a rising trend during the second half of the year.

7.0 **THE ECONOMY AND INTEREST RATES (commentary provided by Link Asset Services - external treasury advisors)**

7.1 During the calendar year of 2017, there was a major shift in expectations in financial markets in terms of how soon Bank Rate would 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 European Union (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 Gross Domestic Product (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 Monetary Policy Committee (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%.

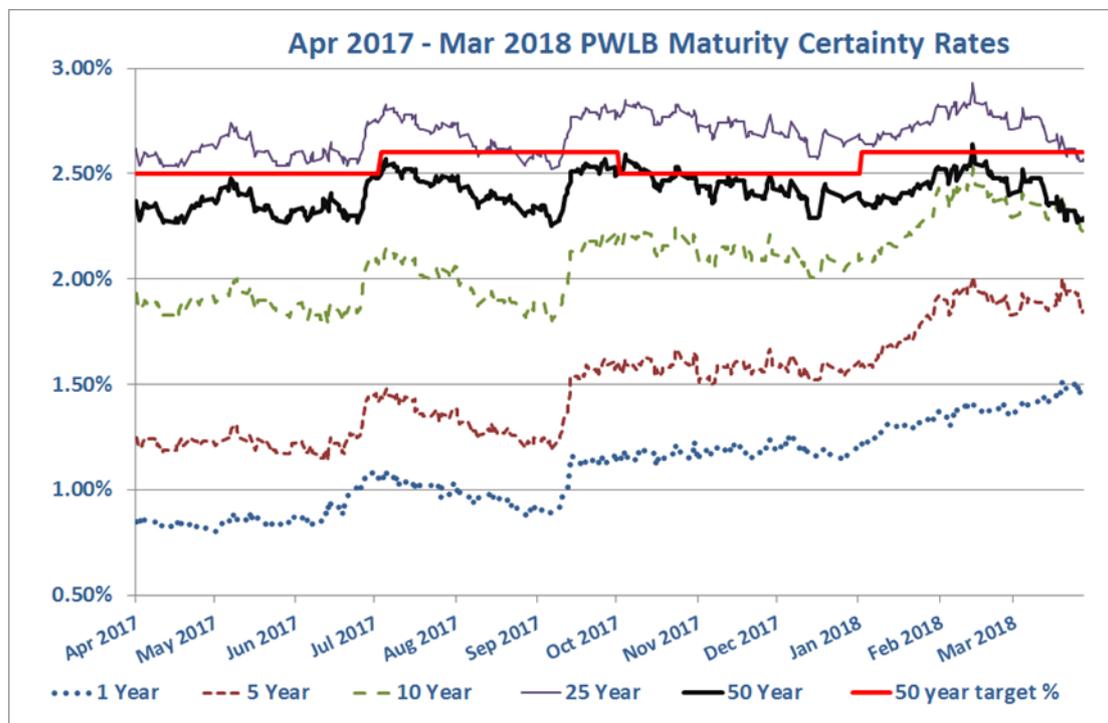
The 8 February MPC meeting minutes then revealed another sharp hardening in MPC warnings on a more imminent and faster pace of increases in Bank Rate than had previously been expected.

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.

7.2 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 United States (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.

8.0 BORROWING RATES IN 2017/18

8.1 PWLB certainty maturity borrowing rates - the following graph shows PWLB certainty maturity rates for a selection of maturity periods throughout the financial year.



9.0 BORROWING OUTTURN FOR 2017/18

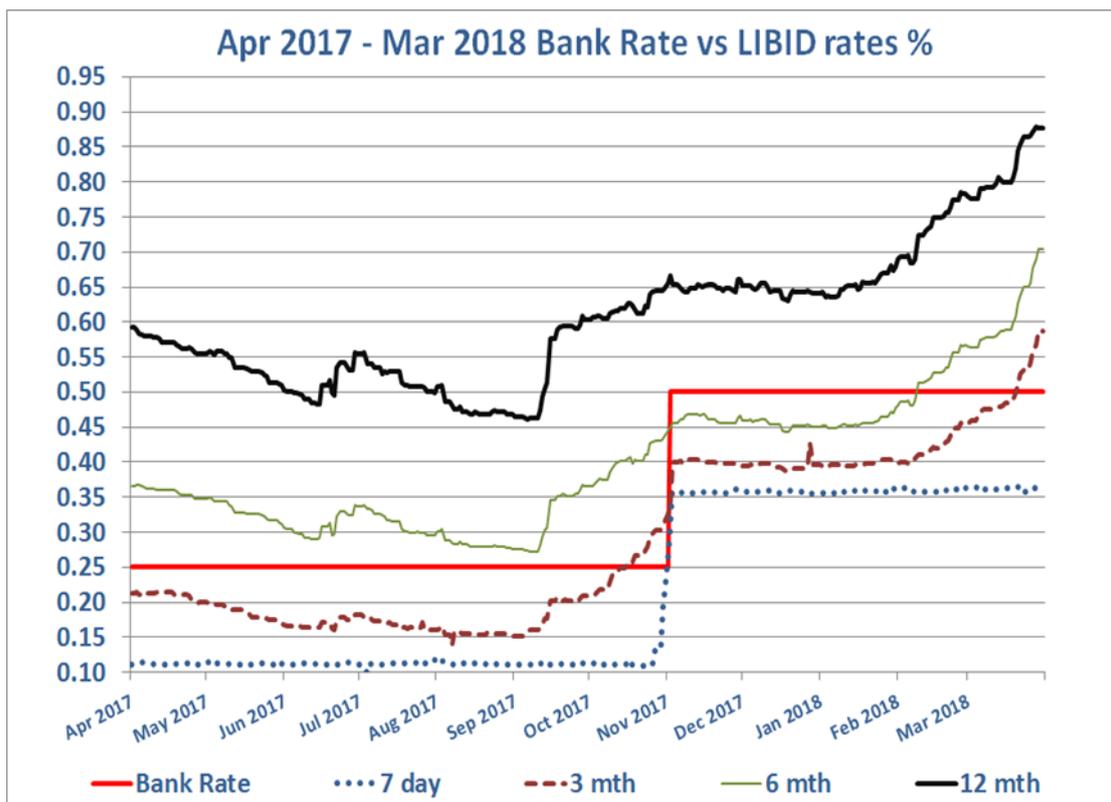
9.1 Due to investment concerns, both counterparty risk and low investment returns, no new borrowing was undertaken during the year.

9.2 No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

9.3 The table in paragraph 5.1 provides a summary of borrowing as at 31 March 2018.

10.0 INVESTMENT RATES IN 2017/18

10.1 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 02/11/17 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 28/02/18.



11.0 **INVESTMENTS OUTTURN FOR 2017/18**

11.1 Investments Policy – the Council’s investment policy is governed by the MHCLG guidance, which has been implemented in the annual investment strategy approved by the Council on 22 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.).

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

11.3 Resources - the Council’s cash balances comprise revenue and capital resources and cash flow monies. The Council’s core cash resources comprised as follows:

Balance Sheet Resources (£’000)	31 March 2017	31 March 2018
Balances	11,182	15,062
Earmarked Reserves	8,543	7,819
Major Repairs Reserve	6,696	4,304
Capital Grants and Contributions	1,612	1,841
Usable capital receipts	3,572	6,435
Total	31,605	35,461

- 11.4 Investments held by the Council - the Council maintained an average balance of £41.7m of internally managed funds. The internally managed funds earned an average rate of return of 0.622%. The comparable performance indicator is the average 3 Month London Interbank Bid rate, which was 0.286%.
- 11.5 Actual investment interest earned during 2017/18 was £259k against an original budget of £150k. The main reasons for the increase were higher than anticipated interest rates available in the market during the second half of the financial year and higher than anticipated levels of investment balances.
- 11.6 As mentioned in paragraph 5.2 the Council has now issued two loans totalling £1.529m to Welland Homes Limited, which is the Council's wholly owned Housing Development Company. These are service loans and the Council receives interest of 3.5% and 5.5% on these loans which is payable on a quarterly basis. Total interest earned on these loans during the year was £41,124.
- 12.0 **REVISED CIPFA CODES, MHCLG INVESTMENT GUIDANCE AND MHCLG MINIMUM REVENUE PROVISION GUIDANCE**
- 12.1 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.
- 12.2 CIPFA accepts that the issue of revised codes in December 2017 will have made it very difficult for authorities to implement both codes for the 2018/19 budget cycle. Full implementation is not expected until the 2019/20 budget cycle across all authorities.
- 12.3 Revised MHCLG investment guidance was issued on 02/02/18. This focused particularly on non-financial asset investments. The effective definition of a short-term investment as being repayable 'within 12 months' in the 2010 investment guidance, has been removed from the 2018 guidance. A long term investment is now therefore one in excess of 365 days.
- 12.4 The MHCLG MRP guidance was issued on 02/02/18. This has focused particularly on expenditure on purchasing non-financial asset investments. There are also changes to guidance on retrospective changes to MRP policy.
- 13.0 **MARKETS IN FINANCIAL INSTRUMENTS DIRECTIVE II (MiFID II)**
- 13.1 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.
- 14.0 **OPTIONS**
- 14.1 There are no alternative options presented.

15.0 REASONS FOR RECOMMENDATION

15.1 To comply with the Chartered Institute of Public Finance and Accountancy's Code of Practice on Treasury Management 2017.

16.0 EXPECTED BENEFITS

16.1 The report provides Members with a summary of the economy, the effect it has had on financial markets and the treasury activity during 2017/18. The report requires scrutiny prior to submitting to Council for approval.

17.0 IMPLICATIONS

17.1 Constitution & Legal

17.1.1 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 and the CIPFA Prudential Code for Capital Finance in Local Authorities.

17.1.2 The Council's financial strategy, capital financing and borrowing all form part of the Policy Framework and are therefore non-executive matters that fall within the remit of the full Council.

17.2 Financial

17.2.1 The report provides details of the treasury activity for the 2017/18 financial year to inform members on performance and to highlight any changes in the year.

17.2.2 Total interest received was £259k with £173k to the General Fund and £86k to the Housing Revenue Account.

17.3 Risk Management

17.3.1 The Council's investment policy has regard to the MHCLG Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities are security first, liquidity second, then return.

18.0 WARDS/COMMUNITIES AFFECTED

18.1 Due to budgetary considerations all wards are affected.

19.0 ACRONYMS

19.1 CPBS – Compass Point Business Services

19.2 CIPFA – Chartered Institute of Public Finance and Accountancy

19.3 HRA – Housing Revenue Account

19.4 CFR – Capital Financing Requirement

19.5 PWLB – Public Works Loan Board

19.6 MRP – Minimum Revenue Provision

19.7 VRP – Voluntary Revenue Provision

19.8 MHCLG – Ministry of Housing, Communities and Local Government

- 19.9 EU – European Union
- 19.10 GDP – Gross Domestic Product
- 19.11 MPC – Monetary Policy Committee
- 19.12 US – United States
- 19.13 MiFID – Markets in Financial Instruments Directive

Background papers: - SHDC Treasury Management Strategy Statement 2017/18

Lead Contact Officer

Name and Post: Sean Howsam – Finance Manager Treasury (CPBS)
Telephone Number: 01507 613248
Email: sean.howsam@cpbs.com

Key Decision: No

Exempt Decision: No

This report refers to a Mandatory Service

Appendices attached to this report: None