Report to:	**Cabinet**
Date:	**11th July 2018**
Title:	**Treasury Management Annual Report 2017-18**
Report of:	**Deputy Chief Executive**
Cabinet member:	**Councillor Stephen Holt, Financial Services**
Ward(s):	**All**
Purpose of report:	**To report on the activities and performance of the Treasury Management service during 2017/2018**
Decision type:	**Budget and Quality Framework**
Officer recommendation(s):	**(1) Agree the annual Treasury Management report for 2017/18.** **(2) Approve the 2017/18 prudential and treasury indicators included.** **(3) Approve the re-profiling of the Authorised Limit and Operational Boundary.**
Reasons for recommendations:	**Requirement of CIPFA Treasury Management in the Public Sector Code of Practice (the Code) and this has to be reported to Full Council in September 2018.**
Contact Officer(s):	**Name: Janet Martin** **Post title: Principal Accountant** **E-mail: janet.martin@lewes-eastbourne.gov.uk** **Telephone number: 01323 415983**

1 Introduction

1.1 This Council is required through regulations issued under the Local Government Act 2003 to produce an annual treasury report reviewing treasury management 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 minimum reporting requirements were that the full Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 22 February 2017)
- a mid year (minimum) treasury update report (Council 15 November 2017)

- an annual report following the year describing the activity compared to the strategy (this report).

In addition Treasury Management updates are included in the quarterly performance management reports, considered by both the Cabinet and Scrutiny Committee.

Recent changes in the regulatory environment place a much greater onus on Members for the review and scrutiny of treasury management policy and activities. This report is 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 & Governance Committee before they were reported to the full Council. Member training on treasury management issues was undertaken on 23 November 2015 in order to support Members' scrutiny role.

1.2 This report summarizes:

- Capital activity during the year;
- Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement (CFR));
- Reporting of the required prudential and treasury indicators and changes to be approved;
- Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances;
- Summary of interest rate movements in the year;
- Debt activity and investment activity.

2.0 The Council's Capital Expenditure and Financing 2017/18

2.1 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.

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 Estimate £m	2017/18 Actual £m
Non-HRA capital expenditure	21.19	71.3	45.0
HRA capital expenditure	5.76	8.8	6.3
Total capital expenditure	**26.95**	**80.1**	**51.3**
Resourced by:			
• Capital receipts	3.00	4.0	1.4
• Capital grants & external funding	5.93	10.3	9.9
• Capital Reserves	3.84	6.6	4.9
• Revenue	-	0.6	-
Use of internal balances/ borrowing	**14.18**	**58.6**	**16.2**

3.0 The Council's overall borrowing need

3.1 The Capital Financing Requirement (CFR) represents the Council's total underlying need to borrow to finance capital expenditure, i.e. capital expenditure that has not been resourced from capital receipts, capital grants and contributions or the use of reserves. Some of this borrowing is from the internal use of cash balances.

3.2 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 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.

3.3 **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-Housing Revenue Account (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).

3.4 The Council's 2017/18 MRP Policy (as required by CLG Guidance) was approved as part of the Treasury Management Strategy Report for 2017/18 on 8 February 2017.

The Council's CFR for the year is shown below, and represents a key prudential indicator. The figures include a credit sales agreement on the balance sheet, which increases the Council's borrowing need, the CFR.

CFR	31 March 2017 Actual £m	31 March 2018 Original Indicator £m	31 March 2018 Actual £m
Opening balance	75.09	88.9	88.9
Add unfinanced capital expenditure (per table 2.0)	14.18	58.6	35.0
Less MRP	(0.39)	(1.3)	(1.3)
Closing balance	88.88	146.2	122.6

3.5 The borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the Authorised Limit.

Net borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term the Council's external borrowing, net of investments, must only be for a capital purpose. This essentially means that the Council is not borrowing to support revenue expenditure. Net borrowing should not therefore, except in the short term, have exceeded the CFR for 2016/17 plus the expected changes to the CFR over 2017/18 and 2018/19. This indicator allows the Council some flexibility to borrow in advance of its immediate capital need in 2016/17. The table below highlights the Council's net borrowing position against the CFR. The Council has complied with this prudential indicator.

	31 March 2017 Actual £m	31 March 2018 Original £m	31 March 2018 Actual £m
Net borrowing position	55.10	124.0	105.1
CFR	88.88	146.2	122.6

The Authorised limit - the Authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. 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.

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.

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	£161.2m
Maximum gross borrowing position	£124.0m
Operational boundary	£146.2m
Average gross borrowing position	£89.1m
Financing costs as a proportion of net revenue stream:	
Non HRA	10.3%
HRA	12.3%

4.0 Treasury Position as at 31 March 2018

4.1 The Council's debt and investment position is organised by staff within Financial Services 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 detailed in the summary, 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 was as follows:

TABLE 1	31 March 2017 Principal	Rate/Return	31 March 2018 Principal	Rate/Return
Fixed rate funding:				
-PWLB	£46.55m		£67.6m	
-Market	£13.50m		£37.5m	
- Serco Paisa	£0.76m		£0.4m	
Total debt	**£65.81m**	**3.66%**	**£105.5m**	**2.87%**
CFR	£88.9m		£122.6m	
Over/ (under)	(£23.09m)		(£17.2m)	

borrowing				
Total investments	**£0m**		**£0m**	

The Council held cash balances of £3.6m in a current account and on call on which interest of 0.4% and 0.5% was being earned.

4.2 The maturity structure of the debt portfolio excluding Serco Paisa was as follows:

	31 March 2017 Actual £m	2017/18 Original limits £m	31 March 2018 Actual £m
Under 12 months	10.00	4.00	23.00
12 months and within 24 months	4.00	-	5.00
24 months and within 5 years	9.02	12.0	14.02
5 years and within 10 years	4.14	2.1	1.52
10 years and above	37.89	59.6	61.51

The exposure to fixed and variable rates (including Serco Paisa) was as follows:

	31 March 2017 Actual £m	2017/18 Original Limits £m	31 March 2018 Actual £m
Principal - Debt Fixed rate	65.81	124.0	105.5
Principal – Investments Variable rate	0	N/a	0

5.0 The Strategy for 2017/18

5.1 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 31.12.19. 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.

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.

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.

6.0 Borrowing Outturn for 2017/18

6.1 Treasury Borrowing.

Borrowing – new loans totalling £24m were drawn down from PWLB in 2017/18 to fund the net unfinanced capital expenditure and to replace maturing loans. Various temporary loans were taken to cover cash flow requirements. The loans drawn were all fixed rate as follows:

Lender - Temp Debt	Principal £m	Interest Rate	Start Date	Maturity
Runnymeade DC	2.0	0.30%	10/02/2017	10/05/2017
Middlesbrough BC	5.0	0.36%	22/03/2017	15/05/2017
Runnymeade DC	2.0	0.35%	10/05/2017	21/08/2017
Middlesbrough BC	5.0	0.30%	15/05/2017	09/08/2017
Lewes DC	3.0	0.32%	30/05/2017	30/08/2017
N Yorkshire CC	5.0	0.45%	30/05/2017	29/05/2018
Edinburgh CC	4.5	0.20%	30/06/2017	31/07/2017
Manchester CC	3.5	0.18%	31/07/2017	08/09/2017
Middlesbrough BC	5.0	0.17%	09/08/2017	08/09/2017
Lewes DC	3.0	0.26%	30/08/2017	30/11/2017
Lewes DC	4.0	0.25%	08/09/2017	08/12/2017
Middlesbrough	6.0	0.19%	25/09/2017	26/10/2017
Middlesbrough BC	2.0	0.30%	20/10/2017	05/01/2018
Middlesbrough	6.0	0.20%	26/10/2017	24/11/2017
Middlesbrough BC	6.0	0.37%	24/11/2017	31/01/2018
Middlesbrough BC	1.0	0.37%	24/11/2017	31/01/2018
Vale of Glamorgan CC	3.0	0.40%	30/11/2017	19/02/2018
Middlesbrough BC	7.0	0.40%	31/01/2018	09/03/2018
Vale of Glamorgan CC	3.0	0.70%	19/02/2018	20/08/2018
N Yorkshire CC	4.0	0.85%	09/03/2018	20/04/2018
Middlesbrough BC	7.0	0.70%	14/03/2018	15/05/2018

Lender - Long Term Debt	Principal £m	Interest Rate	Start Date	Maturity
PWLB	2.0	2.43%	15/05/2017	24/09/2058
PWLB	2.0	2.41%	15/05/2017	24/03/2062
PWLB	2.0	2.40%	15/05/2017	24/03/2065
PWLB	2.0	2.33%	22/05/2017	24/09/2066
PWLB	2.0	2.33%	22/05/2017	24/03/2067
PWLB	2.0	2.39%	11/08/2017	24/09/2066
PWLB	2.0	2.33%	15/08/2017	24/09/2065
PWLB	2.0	2.30%	31/08/2017	24/09/2062

PWLB	2.0	2.38%	23/11/2017	24/03/2064
PWLB	4.0	2.40%	01/03/2018	24/09/2067
PWLB	2.0	2.33%	22/03/2018	24/09/2064

This compares with a budget assumption of borrowing at an interest rate of 3.0%.

Rescheduling – no debt rescheduling was carried out during the year as there was no financial benefit to the Council.

Repayment – £3m of long term PWLB debt was repaid at maturity on 24 September 2017. Various temporary loans were repaid during the year, see table above.

Summary of debt transactions – the overall position of the debt activity resulted in a fall in the average interest rate by 0.79%, representing a saving to the General Fund.

7.0 Interest Rates in 2017/18

7.1 The tight monetary conditions following the 2008 financial crisis continued through 2017/18 with little material movement in the shorter term deposit rates.

7.2 Bank Rate was at an historical low of 0.25% during the year until November 2017 when it rose to 0.5%. Investment rates remained very low. With many financial institutions failing to meet the Council's investment criteria, the opportunities for investment returns were limited. The investment rates at the beginning, average and end of the year are provided below.

Investment Term	Interest Rate March 2017	Average Rate	Interest rate April 2018
Overnight	0.11%	0.28%	0.45%
1 Month	0.13%	0.31%	0.50%
3 Months	0.21%	0.48%	0.75%
6 Months	0.37%	0.63%	0.90%
12 Months	0.59%	0.79%	1.00%

The PWLB rates (including the 0.2% reduction for Certainty Rate) at the beginning, average and end of the year are provided below.

Loan Term	Interest Rate March 2017	Average Rate	Interest rate April 2018
1 Year	0.83%	1.14%	1.45%
5 Years	1.24%	1.55%	1.86%
10 Years	1.91%	2.07%	2.24%
25 Years	2.60%	2.58%	2.56%
50 Years	2.35%	2.31%	2.28%

8.0 Investment Outturn for 2017/18

8.1 **Investment Policy** – the Council's investment policy is governed by CLG guidance, which was 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.).

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

8.3 **Resources** – the Council's longer term cash balances comprise, primarily, revenue and capital resources, although these will be influenced by cash flow considerations. The Council's core cash resources comprised as follows, and met the expectations of the budget:

Balance Sheet Resources	31 March 2017 £m	31 March 2018 £m
Balances	2.66	3.03
Earmarked reserves	8.98	8.70
HRA	4.37	5.19
Major Repairs Reserve	0.51	0.86
Capital Grants & Contributions	5.61	4.77
Usable capital receipts	5.16	7.54
Total	**27.29**	**30.09**

8.4 **Investments held by the Council** - the Council maintained an average balance of £8.3m of internally managed funds. The internally managed funds earned an average rate of return of 0.46%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.36%. This excludes the Council's investment with Lloyds Bank of £1m for 5 years (maturing January 2019) at 3.03% which supports the Local Authority Mortgages Scheme (LAMS).

9.0 The Economy and Interest Rates Forecast

9.1 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 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 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.

9.2 The Council's treasury advisor, Link (previously known as Capita), provides the following forecast as at 20th June 2018:

Bank Rate	NOW	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Link Asset Services	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%
Capital Economics	0.50%	0.50%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%	1.50%	1.50%	1.75%	-
5yr PWLB Rate	NOW	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Link Asset Services	1.84%	1.90%	2.00%	2.00%	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.40%	2.50%	2.50%
Capital Economics	1.84%	1.80%	2.00%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	-
10yr PWLB Rate	NOW	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Link Asset Services	2.27%	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%
Capital Economics	2.27%	2.30%	2.40%	2.80%	2.80%	2.80%	2.80%	2.80%	2.80%	2.80%	2.80%	2.80%	-
25yr PWLB Rate	NOW	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Link Asset Services	2.65%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%	3.50%	3.50%
Capital Economics	2.65%	2.85%	2.95%	3.30%	3.30%	3.30%	3.30%	3.30%	3.30%	3.30%	3.30%	3.30%	-
50yr PWLB Rate	NOW	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Link Asset Services	2.41%	2.40%	2.50%	2.60%	2.70%	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%
Capital Economics	2.41%	2.65%	2.80%	3.15%	3.15%	3.15%	3.15%	3.15%	3.15%	3.15%	3.15%	3.15%	-

The Link central forecast is for the Bank Rate to increase to 0.75% in quarter 2 of 2019.

10 Executive Summary and Conclusion

10.1 During 2017/18, the Council complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

Actual prudential and treasury indicators	2016/17 Actual £m	2017/18 Original £m	2017/18 Actual £m
Actual capital expenditure	26.95	80.1	51.3
Total Capital Financing Requirement: • Non-HRA • HRA • Total	 47.18 41.70 88.88	 103.7 42.5 146.2	 80.0 42.6 122.6
Net borrowing	65.1		105.1
External debt	65.1		105.1
Investments (all under 1 year)	-		-

Other prudential and treasury indicators are to be found in the main body of this report. The Deputy Chief Executive also confirms that borrowing was only undertaken for a capital purpose and the statutory borrowing limit (the Authorised limit), was not breached.

The financial year 2017/18 continued the challenging environment of previous years; low investment returns and continuing counterparty risk continued.

11 Corporate plan and council policies

11.1 The priority themes were considered as part of the overall Capital Programme which forms part of the Tresury Management Strategy.

12 Financial appraisal

12.1 Financial appraisals were considered as part of the overall Capital Programme which forms part of the Tresury Management Strategy.

13 Legal implications

13.1 Comment from the Legal Services Team is not necessary for this routine monitoring report.

14 Risk management implications

14.1 Risks relating to the timing of borrowing and terms of borrowing are considered and advice is provided by Link. Risk management is considered for each of the schemes within the Capital Programme.

15 Equality analysis

15.1 Equality issues are considered

16 Appendices

There are no appendices to this report.

17 Background papers

The Background Papers used in compiling this report were as follows:

CIPFA Treasury Management in the Public Services code of Practice (the Code)
Cross-sectorial Guidance Notes
CIPFA Prudential Code
Treasury Management Strategy and Treasury Management Practices adopted by the Council on 18 May 2010.

To inspect or obtain copies of background papers please refer to the contact officer listed above.