TREASURY MANAGEMENT ANNUAL REPORT 2017/18

1. INTRODUCTION AND BACKGROUND

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 the financial year 2017/18. This report meets the requirements of both the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

The CIPFA Code of Practice on Treasury Management was adopted by this Council on 24 February 2010; this was updated in November 2011 and updated further in December 2017.

The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
3. Receipt by the Full Council of an annual treasury management strategy report (including the annual investment strategy*)* for the year ahead and an annual review report of the previous year.
4. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
5. Delegation by the Council of the role of scrutiny of the treasury management strategy to a specific named body which in this Council is the Finance, Resources and Partnerships Scrutiny Committee.
6. Delegation by the Council of the role of scrutiny of treasury management performance to a specific named body which in this Council is the Audit and Standards Committee, a midyear and year-end review report is received by this Committee.

Treasury management in this context 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. "

The purpose of this report is to meet one of the above requirements of the CIPFA Code, namely the annual review report of treasury management activities, for the financial year 2017/18.

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 has complied with the requirement under the Code to give prior scrutiny to the annual review report by reporting this to the Audit and Standards Committee prior to it being reported to Full Council.

2. THIS ANNUAL TREASURY REPORT COVERS

- The Council's treasury position as at 31 March 2018;
- The strategy for 2017/18;
- The economy in 2017/18;

- Investment rates in 2017/18;
- Compliance with treasury limits and Prudential Indicators;
- Investment outturn for 2017/18;
- Involvement of Elected Members;
- Other issues.

3. TREASURY POSITION AS AT 31 MARCH 2018

The Council's investment position at the beginning and the end of the year was as follows:

	At 31/03/18	Return	Average Life (Days)	At 31/03/17	Return	Average Life (Days)
Total Debt	£2.5m	0.95%	14	£0m	N/A	N/A
Total Investments	£0m	0.37%	2	£3.4m	0.60%	8

It should be noted that the above table is only a snapshot of the total Investments as at 31 March 2018. £2.5m was borrowed on 20 March 2018 to reflect a temporary cash flow position, this was repaid on 3 April 2018 following the receipt of the expected Council Tax and Business Rates payments by direct debit. Large fluctuations in cash inflows and outflows that occur throughout the month can have an impact on the figure reported.

4. THE STRATEGY FOR 2017/18

The strategy agreed by Council on 22 February 2017 was that:

- The Council's had no Borrowing Need for 2017/18, due to the Council expecting to have funds available and no borrowing requirement, this was estimated to rise to £6m in future years, to allow for the possibility that the Council may need to borrow to finance capital expenditure which cannot be funded from other revenue or capital resources;

- Short term external loans (i.e. repayable on demand or within 12 months) can be taken to fund any temporary capital or revenue borrowing requirement. The amounts involved would fluctuate according to the cash flow position at any one time;

- All borrowing would be kept absolutely within the Authorised Limit of £15m and would not normally exceed the Operational Boundary of £7.5m (although it could for short periods of time be permitted to rise to a figure between £7.5m and £15m due to variations in cash flow);

- Temporary surpluses which might arise would be invested, either in short term deposits with the Council's various deposit accounts or in money market investments (cash deposits) if the size warranted this and for an appropriate period in order that these sums would be available for use when required;

- The proportions of loans and investments to be at fixed or variable rates were: fixed rate loans to be between 0% and 100% of the total and variable rate to be between 0% and 100% of the total, thus enabling maximum flexibility to take advantage of interest rate trends;

- Long term investments to be permitted as follows: maturing beyond 31/03/17 £5m, maturing beyond 31/03/18 £5m, maturing beyond 31/03/19, £5m;

- The overriding consideration is safeguarding the Council's capital. At all times the risk to the Council will be minimised. Within these constraints, the aim will be to maximise the return on investments; and,

- Forward commitment of funds for investment is permitted in respect of in house investments, in instances where market conditions warrant it.

5. THE ECONOMY AND INTEREST RATES - narrative supplied by the Council's Treasury Management Advisors – Arlingclose Limited

The United Kingdom (UK) economy showed signs of slowing with latest estimates showing Gross Domestic Product (GDP), helped by an improving global economy, grew by 1.8% during 2017, the same level as in 2016. This was a far better outcome than the majority of forecasts following the European Union (EU) Referendum in June 2016, but it also reflected the international growth momentum generated by the increasingly buoyant United States economy and the re-emergence of the Eurozone economies.

The inflationary impact of rising import prices, a consequence of the fall in sterling associated with the EU referendum result, resulted in the year-on-year Consumer Price Index (CPI) rising to 3.1% in November before falling back to 2.7% in February 2018. Consumers felt the squeeze as real average earnings growth, i.e. after inflation, turned negative before slowly recovering.

The inherent weakness in UK business investment was not helped by political uncertainty following the surprise General Election in June and by the lack of clarity on Brexit, the UK and the EU only reaching an agreement in March 2018 on a transition which will now be span Q2 2019 to Q4 2020. The Withdrawal Treaty is yet to be ratified by the UK parliament and those of the other 27 EU member states and new international trading arrangements are yet to be negotiated and agreed.

6. INVESTMENT RATES IN 2017/18 – narrative supplied by the Council's Treasury Management Advisors – Arlingclose Limited

The Bank of England's Monetary Policy Committee (MPC) increased Bank Rate by 0.25% in November 2017. It was significant in that it was the first rate hike in ten years, although in essence the MPC reversed its August 2016 cut following the referendum result. The February Inflation Report indicated the MPC was keen to return inflation to the 2% target over a more conventional (18-24 month) horizon with 'gradual' and 'limited' policy tightening. Although in March two MPC members voted to increase policy rates immediately and the MPC itself stopped short of committing itself to the timing of the next increase in rates, the minutes of the meeting suggested that an increase in May 2018 was highly likely.

The increase in Bank Rate resulted in higher money markets rates: 1-month, 3-month and 12-month rates averaged 0.32%, 0.39% and 0.69% and at 31st March 2018 were 0.43%, 0.72% and 1.12% respectively.

Gilt yields displayed significant volatility over the twelve-month period with the change in sentiment in the Bank of England's outlook for interest rates. The yield on the 5-year gilts which had fallen to 0.35% in mid-June rose to 1.65% by the end of March. 10-year gilt yields also rose from their lows of 0.93% in June to 1.65% by mid-February before falling back to 1.35% at year-end. 20 year gilt yields followed an even more erratic path with lows of 1.62% in June, and highs of 2.03% in February, only to plummet back down to 1.70% by the end of the financial year.

7. CHANGES DURING 2017/18

Revised CIPFA Codes

CIPFA published revised editions of the Treasury Management and Prudential Codes in December 2017. The required changes from the 2011 Code have been incorporated into Treasury Management Strategies and monitoring reports.

The 2017 Prudential Code introduces the requirement for a Capital Strategy which provides a high-level overview of the long-term context of capital expenditure and investment decisions and their associated risks and rewards along with an overview of how risk is managed for future financial sustainability. Where this strategy is produced and approved by full Council, the determination of the Treasury Management Strategy can be delegated to a committee. The Code also expands on the process and governance issues of capital expenditure and investment decisions.

The Council has an existing Capital Strategy for the period 2015 to 2019; this was approved by Council on 25 February 2015.

In the 2017 Treasury Management Code the definition of 'investments' has been widened to include financial assets as well as non-financial assets held primarily for financial returns such as investment property. These, along with other investments made for non-treasury management purposes such as loans supporting service outcomes and investments in subsidiaries will be discussed in the Investment Strategy, within the Treasury Management Strategy. Additional risks of such investments will be set out clearly and the impact on financial sustainability will be identified and reported.

Ministry of Housing, Communities and Local Government (MHCLG) Investment Guidance and Minimum Revenue Provision (MRP)

In February 2018 the MHCLG published revised Guidance on Local Government and Investments and Statutory Guidance on Minimum Revenue Provision (MRP).

Changes to the Investment Guidance include a wider definition of investments to include non-financial assets held primarily for generating income return and a new category called "loans" (e.g. temporary transfer of cash to a third party, joint venture, subsidiary or associate). The Guidance introduces the concept of proportionality, proposes additional disclosure for borrowing solely to invest and also specifies additional indicators. Investment strategies must detail the extent to which service delivery objectives are reliant on investment income and a contingency plan should yields on investments fall.

The definition of prudent MRP has been changed to "put aside revenue over time to cover the Capital Financing Requirement (CFR)"; it cannot be a negative charge and can only be zero if the CFR is nil or negative. Guidance on asset lives has been updated, applying to any calculation using asset lives. Any change in MRP policy cannot create an overpayment; the new policy must be applied to the outstanding CFR going forward only.

Markets in Financial Instruments Directive (MiFID II)

As a result of the second Markets in Financial Instruments Directive (MiFID II), from 3rd January 2018 local authorities were automatically treated as retail clients but could "opt up" to professional client status, providing certain criteria was met which includes having an investment balance of at least £10 million and the person(s) authorised to make investment decisions on behalf of the authority have at least a year's relevant professional experience. In addition, the regulated financial services firms to whom this directive applies have had to assess that that person(s) have the expertise, experience and knowledge to make investment decisions and understand the risks involved.

The Authority has not and does not plan to opt up to professional status as this would expose the Council to unnecessary borrowing costs and risk with no significant benefit. This may lead to some increased costs and restrictions in accessing financial products. The main protection in being a retail client is a duty on the firm to ensure that the investment is "suitable" for the Authority. It should be noted that local authorities' investments are not protected by the Financial Services Compensation Scheme nor are they eligible to complain to the Financial Ombudsman Service regardless of whether they are retail or professional clients.

8. COMPLIANCE WITH TREASURY LIMITS

During the financial year the Council operated within the treasury limits and Prudential Indicators set out in the Council's annual Treasury Strategy Statement. The outturn for the Prudential Indicators is shown in Annex 1.

9. INVESTMENT OUTTURN FOR 2017/18

Internally Managed Investments

The Council manages its investments in-house and during 2017/18 invested with institutions in compliance with the credit worthiness service of the Council's treasury management advisors, Arlingclose Limited.

The Council invested for a range of periods from overnight to up to two months during 2017/18, dependent on the Council's cash flows, its interest rate view and the interest rates on offer. Thirteen of the eighteen investments made in 2017/18 were for a period of two weeks or less. All eighteen investments were deposited in the Council's business reserve account due to the available rate and liquidity. No fixed investments were made during 2017/18.

In addition funds that were held in the general fund account that the Council has with Lloyds Bank also earn interest on a daily basis.

Investment Outturn for 2017/18

During 2017/18 an average rate of return of 0.37% was achieved on an average individual investment of £4.123m. This compared with the target of 0.45% included in the departmental service plan.

10. INVOLVEMENT OF ELECTED MEMBERS

Elected members have been involved in the treasury management process during 2017/18 including:

- Scrutiny of the treasury management strategy by the Finance, Resources and Partnerships Scrutiny Committee prior to being submitted for approval by the Full Council.
- Scrutiny of treasury management performance by the Audit and Standards Committee through the receipt of a half yearly treasury management report.
- A quarterly budget monitoring and performance report is reported to Cabinet, this contains details of Treasury Management activity undertaken during the quarter.

ANNEX 1: PRUDENTIAL INDICATORS

Position/Prudential Indicator		2016/17 Actual	2017/18 Indicator	2017/18 Actual
1	Capital Expenditure	£8.729m	N/A	£6.296m
2	Capital Financing Requirement at 31st March *	£0.828m	(£0)	£4.405m
3	Treasury Position at 31st March: Borrowing Other long term liabilities Total Debt Investments Net Borrowing	 £0 £0 £0 (£3.460m) (£3.460m)	 N/A N/A N/A N/A N/A	 £2.500m £0 £0 £0 £2.500m
4	Authorised Limit (against maximum position)	£0	£15.0m	£0
5	Operational Boundary (against maximum position)	£0	£7.5m	£0
6	Ratio of Financing Costs to Net Revenue Stream	(0.81%)	(1.09%)	(0.46%)
7	Upper Limits on Variable Interest Rates (against maximum position) Loans Investments	 0% 0%	 100% 100%	 0% 0%
8	Actual External Debt	£0	N/A	£0
9	Principal Funds Invested for Periods Longer than 365 days (against maximum position)	£0	£5.0m	£0

GLOSSARY

CFR – Capital Financing Requirement

The Capital Financing Requirement is the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources.

CIPFA – The Chartered Institute of Public Finance and Accountancy

The Chartered Institute of Public Finance and Accountancy, is the professional body for accountants working in Local Government and other public sector organisations.

CPI – Consumer Price Index

A measure that examines the weighted average of prices of a basket of consumer goods and services. The Consumer Price Index is calculated by taking price changes for each item in the predetermined basket of goods/services and averaging them; the goods are weighted according to their importance. Changes in CPI are used to assess price changes associated with the cost of living.

DMO and DMADF - Debt Management Office and Debt Management Account Deposit Facility

The DMADF is the 'Debt Management Account Deposit Facility' which is a highly secure fixed term deposit account with the Debt Management Office, part of Her Majesty's Treasury.

GDP – Gross Domestic Product

Gross Domestic Product is the market value of all officially recognised final goods and services produced within a country in a given period of time.

MIFID II – Markets in Financial Instruments Directive

New European Union rules that came into effect on 3rd January 2018, aiming to improve the functioning of financial markets and to strengthen investor protection.

MPC – Monetary Policy Committee

Interest rates are set by the Bank of England's Monetary Policy Committee. The MPC sets an interest rate it judges will enable the inflation target to be met.

MRP – Minimum Revenue Provision

The Minimum Revenue Provision represents the revenue charge for the repayment of debt.