ANNUAL TREASURY MANAGEMENT REVIEW 2017-18

Meeting	**Council – 6 September 2018**
Report Author	**Tim Willis, Deputy Chief Executive and Section 151 Officer**
Portfolio Holder	**Cllr Ian Gregory, Cabinet Member for Financial Services and Estates**
Status	**For Decision**
Classification:	**Unrestricted**
Key Decision	**No**
Reasons for Key *(if appropriate)*	**N/A**
Previously Considered by	**Governance and Audit Committee - 25 July 2018** **Cabinet - 26 July 2018**
Ward:	**N/A**

Executive Summary:

This report summarises treasury management activity and prudential/ treasury indicators for 2017-18.

Recommendation(s):

That council:

- Notes the actual 2017-18 prudential and treasury indicators in this report.
- Approves the Annual Treasury Management report for 2017-18.

CORPORATE IMPLICATIONS	
Financial and Value for Money	The financial implications are highlighted in this report.
Legal	Section 151 of the 1972 Local Government Act requires a suitably qualified named officer to keep control of the council's finances. For this council, this is the Deputy Chief Executive, Tim Willis, and this report is helping to carry out that function.
Corporate	Failure to undertake this process will impact on the council's compliance with the Treasury Management Code of Practice.
Equalities Act 2010 & Public Sector Equality Duty	There are no equity and equalities implications arising directly from this report, but the council needs to retain a strong focus and understanding on issues of diversity amongst the local community and ensure service delivery matches these.

	It is important to be aware of the council's responsibility under the Public Sector Equality Duty (PSED) and show evidence that due consideration had been given to the equalities impact that may be brought upon communities by the decisions made by council.

CORPORATE PRIORITIES (tick those relevant)✓	
A clean and welcoming Environment	
Promoting inward investment and job creation	
Supporting neighbourhoods	

CORPORATE VALUES (tick those relevant)✓	
Delivering value for money	✓
Supporting the Workforce	
Promoting open communications	

1.0 Introduction and Background

1.1 This council is required by regulations issued under the Local Government Finance 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 Chartered Institute of Public Finance & Accountancy (CIPFA) Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

1.2 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 09-02-2017)
- a mid-year treasury update report (council 08-02-2018)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

1.3 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.

1.4 This council 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 Governance and Audit Committee before they were reported to the full council. Member training on treasury management issues was last undertaken on 21-09-2015 in order to support members' scrutiny role. The council's external treasury management advisor is Link Asset Services (Link).

1.5 The council's 2017-18 accounts have not yet been audited and hence the figures in this report are subject to change.

2.0 Link's Review of the Economy and Interest Rates (issued by Link in April 2018)

2.1 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 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%.

2.2 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.

2.3 Public Works Loan Board (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 treasuries. During the second half of the year, there was a noticeable trend in treasury yields being on a rising trend with the Federal Reserve (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.

2.4 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.

3.0 Overall Treasury Position as at 31 March 2018

3.1 At the beginning and the end of 2017-18 the council's treasury (excluding borrowing by private finance initiatives (PFI) and finance leases) position is outlined in Table 1.

Table 1 - Overall Treasury Position as at 31 March 2018

	31 March 2017 Principal £'000	Rate/ Return	Average Life Years	31 March 2018 Principal £'000	Rate/ Return	Average Life Years
General Fund (GF) debt	11,629	3.14%	14.2	11,046	3.15%	13.9
Housing Revenue Account (HRA) debt	20,040	4.03%	8.9	20,040	4.03%	8.1
Total debt	**31,669**	**3.71%**	**10.8**	**31,086**	**3.71%**	**10.2**
GF CFR	26,706			23,812		

HRA CFR	20,377			20,787		
Total CFR	**47,083**			**44,599**		
Over / (under) borrowing	**(15,414)**			**(13,513)**		
Total investments	**37,988**	**0.49%**		**40,882**	**0.36%**	
Net debt / (investment)	**(6,319)**			**(9,796)**		

4.0 The Strategy for 2017-18

4.1 The expectation for interest rates within the treasury management strategy for 2017-18 was that Bank Rate would stay flat at 0.25% until quarter 2 2019 and not to rise above 0.75% by quarter 1 2020. 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.

4.2 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.

4.3 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.

4.4 **Change in strategy during the year** – the strategy adopted in the original Treasury Management Strategy Report for 2017-18 approved by the council on 09-02-17 was not revised during 2017-18.

5.0 The Borrowing Requirement and Debt

5.1 The council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR) and is shown in Table 2.

Table 2 - Council's Capital Financing Requirement

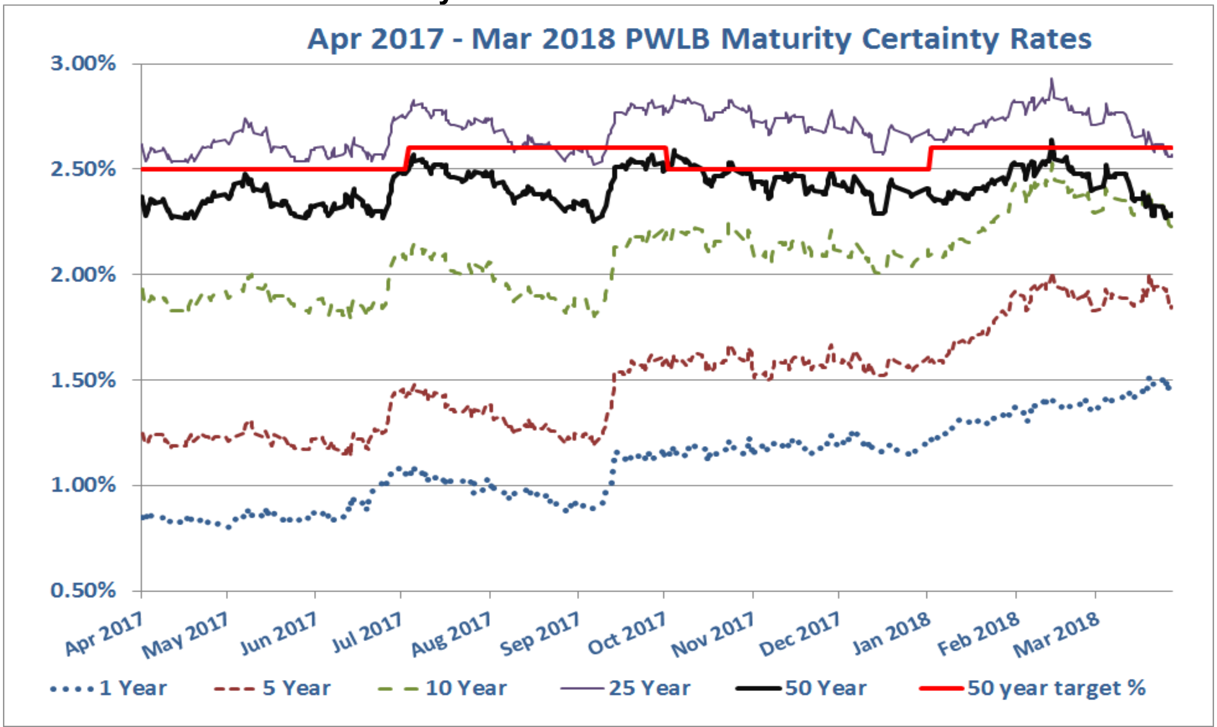
	31 March 2017 Actual £'000	31 March 2018 Budget £'000	31 March 2018 Actual £'000
CFR General Fund (GF)	26,706	30,963	23,812
CFR Housing Revenue Account (HRA)	20,377	27,283	20,787
Total CFR	47,083	58,246	44,599

The main reasons for the CFR variance are capital work which was due to be funded from prudential borrowing slipping from 2017-18 into future years, and settlement of the EKO spine road liability.

6.0 Borrowing Rates in 2017-18

6.1 **Public Works Loan Board (PWLB) certainty maturity borrowing rates -** the graph in Table 3 shows PWLB 25 and 50 year rates have been volatile during the year with little consistent trend. However, shorter rates were on a rising trend during the second half of the year and reached peaks in February / March. During the year, the 50 year PWLB target (certainty) rate for new long term borrowing was 2.50% in quarters 1 and 3 and 2.60% in quarters 2 and 4. The graph for PWLB rates shows, for a selection of maturity periods, the average borrowing rates, the high and low points in rates, spreads and individual rates at the start and the end of the financial year.

Table 3 – PWLB Certainty Rates



7.0 Borrowing Outturn for 2017-18

7.1 **Borrowing** – Table 4 outlines the General Fund loans drawn (from Salix Finance Ltd) to fund net unfinanced capital expenditure and any naturally maturing debt:

Table 4 –General Fund Loans drawn in 2017-18

Principal £000	Type	Interest Rate	Maturity	GF Average Interest Rate for 2017-18
43	Fixed interest rate - EIP	0.00%	01/04/2022	3.15%

Salix Finance Ltd provides interest-free Government funding to the public sector to improve their energy efficiency, reduce carbon emissions and lower energy bills.

This compares with a budget assumption of borrowing at an interest rate of 3% during the year.

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

7.3 **Repayments** – The council repaid £626k of maturing debt using investment balances. Details of these are outlined in Table 5.

Table 5 – Maturing Debt Paid in 2017-18

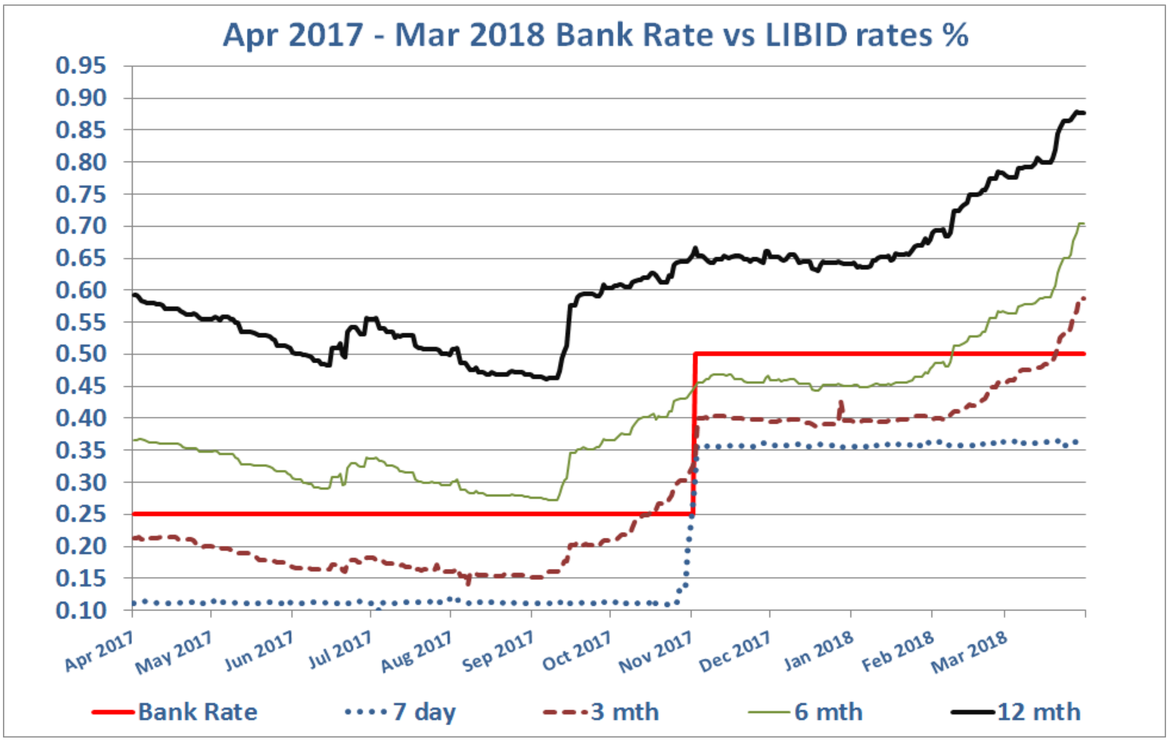
Lender	Principal £'000	Interest Rate	Repayment Date
PWLB	43	3.08%	23-04-17
PWLB	50	2.48%	27-05-17
PWLB	146	1.97%	27-05-17
PWLB	72	1.28%	20-06-17
Salix	4	0.00%	01-10-17
PWLB	43	3.08%	23-10-17
PWLB	50	2.48%	27-11-17
PWLB	146	1.97%	27-11-17
PWLB	72	1.28%	20-12-17
Total	626		

7.4 **Summary of debt transactions** – The average interest rate on the debt portfolio was unchanged during the year at 3.71%.

8.0 Investment Rates in 2017-18

8.1 Investments rates for 3 months and longer have been on a rising trend during the second half of the year in the expectation of Bank Rate increasing from its floor of 0.25%, and reached a peak at the end of March. Bank Rate was duly raised from 0.25% to 0.50% on 2.11.17 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 28.2.18.

Table 6 – Investment Rates



9.0 Investment Outturn for 2017-18

9.1 **Investment Policy** – the council's investment policy is governed by the Ministry of Housing, Communities and Local Government (MHCLG) guidance, which has been implemented in the annual investment strategy approved by the council on 9 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.).

9.2 The investment activity during the year conformed to the approved strategy.

9.3 **Investments held by the council** - the council maintained an average balance of £46.86m of internally managed funds. The internally managed funds earned an average rate of return of 0.36%.The comparable performance indicator is the average 7-day London Interbank Bid Rate (LIBID) rate, which was 0.22%. This compares with a budget assumption of £25m investment balances earning an average rate of 0.13%.

9.4 **Investments held by fund managers** – the council does not use external fund managers.

10.0 Investment risk benchmarking

10.1 The following investment benchmarks were set in the council's 2017-18 annual treasury strategy:

10.2 **Security** - The council's maximum security risk benchmark for the current portfolio, when compared to historic default tables, is:

- 0.05% historic risk of default when compared to the whole portfolio.

10.3 **Liquidity** – in respect of this area the council seeks to maintain:

- Bank overdraft - £0.5m
- Liquid short term deposits of at least £10m available with a week's notice.
- Weighted average life benchmark is expected to be 0.5 years, with a maximum of 1.0 year.

10.4 **Yield** - local measures of yield benchmarks are:

- Investments – internal returns above the 7 day LIBID rate

10.5 The council kept to the above benchmarks during 2017-18.

11.0 Options

11.1 The recommended option (to ensure regulatory compliance as set out in section 1 of this report) is that council:

- Notes the actual 2017-18 prudential and treasury indicators in this report.
- Approves the Annual Treasury Management report for 2017-18.

11.2 Alternatively, council may decide not to do this and provide reason(s) why.

12.0 Disclaimer

12.1 This report is a technical document focussing on public sector investments and borrowings and, as such, readers should not use the information contained within the report to inform personal investment or borrowing decisions. Neither Thanet District Council nor any of its officers or employees makes any representation or warranty, express or implied, as to the accuracy or completeness of the information contained herein (such information being subject to change without notice) and shall not be in any way responsible or liable for the contents hereof and no reliance should be placed on the accuracy, fairness or completeness of the information contained in this document. Any opinions, forecasts or estimates herein constitute a judgement and there can be no assurance that they will be consistent with future results or events. No person accepts any liability whatsoever for any loss howsoever arising from any use of this document or its contents or otherwise in connection therewith.

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Annex List

Annex 1	Prudential and Treasury Indicators
Annex 2	Report Guidance
Annex 3	Abbreviations and Definitions

Corporate Consultation Undertaken

Finance	Ramesh Prashar, Head of Financial Services
Legal	Tim Howes, Director of Corporate Governance & Monitoring Officer