BOROUGH COUNCIL OF WELLINGBOROUGH **AGENDA ITEM** **8**

Resources Committee **13 June 2018**

Report of S151 Officer

TREASURY MANAGEMENT OUTTURN - ANNUAL REPORT 2017-18

1 Purpose of Report

The purpose of this report is to present the annual report of treasury management activity for 2017-18. The treasury management function contributes towards the council's overall objective of the efficient use of resources.

2 Executive Summary

To inform members of the outturn position in respect of the application of the treasury management strategy for 2017-18.

3 Appendices

1. Prudential Indicators for the year 2017-18
2. Economic Overview

4 The Committee Is invited to RECOMMEND to:

4.1 APPROVE the Treasury Management outturn position, as detailed in the report.

5 Background

5.1 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).

5.2 During 2017-18 the minimum reporting requirements were that the Members should receive the following reports:

- an annual treasury strategy in advance of the year (Resources 15 March 2017)
- a mid-year treasury update report (Resources 1 November 2017)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

5.3 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.

5.4 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 Resources Committee before they were reported to the full Council.

5.5 The council's investment policy is governed by Ministry of Housing, Communities and Local Government (MHCLG) guidance, which was implemented in the annual investment strategy approved by the council on 11 April 2017. The Credit Worthiness policy was amended and approved by council on 11 April 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.).

5.6 In the first three months of 2017-18, there were two anticipated breaches of the Annual Investment Strategy, which were reported to Resources Committee on 1 November 2017. Apart from these instances, the council has complied fully with the requirements of its approved Treasury Management Strategy during the period, including use of approved counterparties and investment limits. The council had no liquidity difficulties.

5.7 The council maintained an average balance of £24.6m of internally managed funds, which is a combination of short and long term investments. These investments earned an average rate of return of 0.70% which compares with a budget assumption of £19.5m investment balances earning an average rate of 0.88%.

6 Discussion

Investments

6.1 At 31 March 2018 the Council held the following investments.

Money Market transactions:

Short term investments for periods of less than 1 year:

Investments	Range of Interest Rates Receivable %	Total Investment at 31 March 2017 £'000	Total Investment at 31 March 2018 £'000
Building Societies	0.60% -0.96%	20,124	16,068
Banks	0.15% - 0.85%	-	4,516
Other Local Authorities	0.80%	-	1,000
Total		**20,124**	**21,584**
Bank Balance		2,165	1,432
Total cash available for Investment	0.25-0.50%	**22,289**	**23,016**

The year on year variance for money market investments is therefore a small increase of £1.459m. This is due to a reduction in the level of capital scheme activity and an increase in s106 receipts. The Council did not hold any long term money market investments at 31st March 2018.

6.2 The average rate of interest earned on investments during the year was 0.70% (2016-17 0.88%).

6.3 **Investment Trusts:**

At the 31 March 2018 the Council held long term investments of share capital in the Aberdeen Diversified Income and Growth Trust (previously known as Black Rock Income Strategies Trust) investment with the following comparative values:

	31 March 2017 £000	31 March 2018 £000
Purchase Price	157	157
Market Value	288	295

6.4 The authority's statutory accounts are required to disclose the fair value of investments. The difference in the value of the Aberdeen Diversified Income and Growth Trust Investment, when compared to the historical cost, amounted to an increase in value of £7.5k (in 2016-17 there was a decrease of £15k), due to a rise in the share price to £1.18. The increase in value (£7.5k) has been credited to the Available for Sale Financial Instruments Reserve.

Borrowing

6.5 The authority became debt free in December 2002; consequently the authority has no outstanding borrowings.

Interest Received

6.6 Details of interest received during 2017-18 compared with the estimate are as follows:

	2017-18 Original Estimate £	2017-18 Actual £	Variance Original Est. to Actual £
Amount received;			
Investment income	225,000	172,522	-52,478
Dividends	12,000	13,913	1,913
Other (incl. bank interest)		11,483	11,483
Total	**237,000**	**197,917**	**-39,083**

Future Prospects

6.7 Clearly, future prospects for generating investment income to support the annual revenue budget continue to be dependent on the level of balances and future movement in the level of interest rates. The uncertainties which are inherent to both of these serve to highlight the continuing need for robust treasury management skills internally and external professional advice to assist in achieving future maximum investment returns.

6.8 Investment returns have recovered a little from the exceptionally low levels reached in the aftermath of the financial crisis, but nonetheless remained low during 2017/18, with a gently rising trend in the second half of the year, following the rise in the Bank of England base rate to 0.50% in November 2017. However, banks and building societies continue to be cash rich and therefore do not need as much investment as they did a few years ago. This means that the interest rates that are being offered are remaining at a relatively low level. The interest rate forecasts within the Council's Investment Strategy for 2018/19 onwards are based upon the Base Rate rising to 1% by the end of 2018/19 and by a further 0.25% in each of the succeeding years, to reach 1.5% by the end of 2020/21.

7 Legal Powers

Local Government Act 2003.

8 Financial and Value For Money Implications

As shown in the report.

9 Risk Analysis

Nature of risk	Consequences if realised	Likelihood of occurrence	Control measures
Losses on invested funds	Potentially significant to the Council	Unlikely	Treasury management strategy
Fluctuations in interest rates	Beneficial if interest rates rise, adverse when interest rates fall	Investment income rates continue to be at relatively low levels	Use of external advisors to determine best strategy

10 Implications for Resources

As shown in the report.

11 Implications for Stronger and Safer Communities

No direct implications.

12 Implications for Equalities

No direct implications.

13 Author and Contact Officer

Tracey Cave, Service Accountant

14 Consultees

Samantha Knowles, Assistant Director, S151 Officer
Julie O'Connell, Accountancy Team Leader

15 Background Papers

The Prudential indicators and Treasury Management Report 2017-18
Resources committee 21March 2018.
2017-18 Final Accounts working papers
Information received from Link Assets Services Ltd., the Council's Treasury Management advisers.

Appendix 1

Prudential Indicators for the year 2017-18

The Capital Prudential Indicators 2017/18 – 2020/21

The Council's capital expenditure plans are the key driver of treasury management activity. The outputs of the capital expenditure plans are reflected in prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

Capital Expenditure. This Prudential Indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle.

Capital Expenditure £m	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Total	1.911	6.987	0.292	0.025

Other long term liabilities. The above financing need excludes other long term liabilities, such as PFI and leasing arrangements which already include borrowing instruments. The Council has no finance leases which effectively include borrowing instruments:

The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding need (borrowing).

Capital Expenditure £m	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Total	1.911	6.987	0.292	0.025
Financed by:				
Capital generated in year receipts	1.512	-	-	-
Capital grants	0.530	1.931	-	-
Capital receipts reserves	-0.131	5.056	0.292	0.025
Revenue	-	-	-	-
Net financing need for the year	-	-	-	-

The Council's Borrowing Need (the Capital Financing Requirement)

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR. The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each assets life. Given that all historical capital spending, including that for 2017/18, has been fully funded and that full funding is planned for all future schemes, the Council has a current and projected borrowing need of zero.

The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst this increases the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has no such schemes within the CFR.

The Council's current overall CFR is zero and this is projected to remain unchanged and therefore no borrowing is anticipated in the foreseeable future.

MRP Policy Statement

The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

MHCLG Regulations have been issued which require the full Council to approve **an MRP Statement** in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The authority has no current or planned borrowing requirement or finance lease liability that would give rise to the need for MRP, but for completeness the Council is recommended to approve the following MRP Statement:

a) **Should the Council incur capital expenditure which gives rise to a borrowing requirement, then MRP will be provided for based on the estimated life of the assets concerned.**

b) **The Council will make provision in its revenue accounts each year to meet the costs of the Principal element of any outstanding Finance Leases.**

The Use of the Council's Resources and the Investment Position

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year end balances for each resource and anticipated day to day cash flow balances.

Year End Resources	2017/18 Actual £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
Fund balances / reserves	6.575	5.997	5.116	3.520
Capital receipts	17.361	22.255	22.213	22.438
Capital grants unapplied	0.364	-	-	-
Provisions	0.065	0.065	-	-
Other	- 0.030	-	-	-
Total core funds	**24.335**	**28.317**	**27.329**	**25.958**
Working capital*	-2.751	-2.000	-2.000	-2.000
Under/over borrowing	-	-	-	-
Expected investments	**21.584**	**26.317**	**25.329**	**23.958**

*Working capital balances shown are estimated year end; these may be higher mid year

Affordability Prudential Indicators

The Prudential Code for Capital Expenditure in Local Authorities requires each Council to set and report against indicators showing:

- the cost of servicing long-term borrowing, including both interest costs and provision for loan repayment, as a percentage of total net service costs, and
- the impact on Council Tax levels of funding additional capital expenditure from borrowing.

The previous sections cover the capital prudential indicators, but the prudential indicators required to assess the affordability of the capital investment plans, are not reported because the Council is debt-free and is projected to remain so for the foreseeable future.

Current Portfolio Position

The Council's treasury portfolio position at 31 March 2018, with forward projections are summarised below. The council is currently debt free and there is no need for borrowing to fund the capital programme for the forseeable future.

£m	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
External Debt:				
Debt at 1 April	-	-	-	-
Expected change in Debt	-	-	-	-
Other long-term liabilities (OLTL)	-	-	-	-
Expected change in OLTL	-	-	-	-
Actual debt 31 March :	-	-	-	-
The Capital Financing Requirement	-	-	-	-
Under/(over) borrowing	-	-	-	-
Total investments at 31 March:				
Investments	21,584	26,317	25,329	23,958
Investment change	1,460	4,733	-988	-1,371
Net Debt	**-**	**-**	**-**	**-**

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well defined limits. One of these is that the Council needs to ensure that its total debt, net of any investments, does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2016/17 and the following two financial years (shown as net borrowing above). This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Assistant Director (& Section 151 Officer) reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

Treasury Indicators: Limits to Borrowing Activity

The Operational Boundary. This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

Operational boundary £m	2017/18	2018/19	2018/19	2019/20
	Actual	Estimate	Estimate	Estimate
Debt	-	-	-	-
Other long term liabilities	0.05	0.05	0.05	0.05
Total	0.05	0.05	0.05	0.05

The Authorised Limit for external debt. A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

1. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.
2. The Council approved the following Authorised Limit at the March 21st Resources Committee

Authorised limit £m	2017/18	2018/19	2018/19	2019/20
	Actual	Estimate	Estimate	Estimate
Debt	5.00	5.00	5.00	5.00
Other long term liabilities	0.05	0.05	0.05	0.05
Total	5.05	5.05	5.05	5.05

ECONOMIC OVERVIEW

UK. The outcome of the EU referendum in June 2016 resulted in a gloomy outlook and economic forecasts from the Bank of England based around an expectation of a major slowdown in UK GDP growth, particularly during the second half of 2016, which was expected to push back the first increase in Bank Rate for at least three years. Consequently, the Bank responded in August 2016 by cutting Bank Rate by 0.25% to 0.25% and making available over £100bn of cheap financing to the banking sector up to February 2018. Both measures were intended to stimulate growth in the economy. This gloom was overdone as the UK economy turned in a G7 leading growth rate of 1.8% in 2016, (actually joint equal with Germany), and followed it up with another 1.8% in 2017, (although this was a comparatively weak result compared to the US and EZ).

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; 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, 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 in quarter 3 to 0.5% before dipping slightly to 0.4% in quarter 4.

Consequently, market expectations during the autumn rose significantly that the MPC would be heading in the direction of imminently 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 needing to raise Bank Rate very soon. The 2 November MPC quarterly Inflation Report meeting duly delivered on this warning 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 pessimistically weak while there was little evidence of building pressure on wage increases despite remarkably 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. So this all seemed to add up to cooling expectations of much further action to raise Bank Rate over the next two years.

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 a marked increase in expectations that there would be another Bank Rate increase in May 2018 and a bringing forward of the timing of subsequent increases in Bank Rate. This shift in market expectations 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.

As for equity markets, the FTSE 100 hit a new peak near to 7,800 in early January before there was a sharp selloff in a number of stages during the spring, replicating similar developments in US equity markets.

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, there has been little significant hold up to making progress.

The 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.

EU. Economic growth in the EU, (the UK's biggest trading partner), was lacklustre 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.

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.

China. 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.

Japan. GDP growth has been improving to reach an annual figure of 2.1% in quarter 4 of 2017. However, it is still struggling to get inflation up to its target rate of 2% despite huge monetary and fiscal stimulus, although inflation has risen in 2018 to reach 1.5% in February. It is also making little progress on fundamental reform of the economy.