PERFORMANCE SCRUTINY COMMITTEE **24 MAY 2018**

SUBJECT:	**TREASURY MANAGEMENT STEWARDSHIP AND ACTUAL PRUDENTIAL INDICATORS REPORT 2017/18 (OUTTURN)**
REPORT BY:	**CHIEF FINANCE OFFICER**
LEAD OFFICER:	**SARAH HARDY – GROUP ACCOUNTANT (TECHNICAL & EXCHEQUER)**

1. Purpose of Report

1.1 The annual Treasury Management stewardship report is a requirement of the Council's reporting procedures under regulations issued under the Local Government Act 2003. It covers the 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).

2. Executive Summary

2.1 During 2017/18 the Council complied with its legislative and regulatory requirements. The key prudential indicators for the year, with comparators, are as follows:

Actual Prudential Indicators	**2017/18 £000**	**2016/17 £000**
Actual Capital Expenditure	39,805	27,949
Capital Financing Requirement		
General Fund	50,977	30,173
HRA	58,503	58,503
Total	**109,480**	**88,676**
Net borrowing (borrowing less investments)	**60,344**	**54,594**
External debt (borrowing)	**81,104**	**75,354**
Investments		
• Longer than 1 year*	0	0
• Under 1 year	15,600	20,760
• Total	**15,600**	**20,760**

Other prudential and treasury indicators are to be found in section 4.

3. Background

3.1 The prudential system for capital expenditure is now well established. One of the requirements of the Prudential Code is to ensure adequate monitoring of the capital expenditure plans, prudential indicators (PIs) and treasury management response to these plans. This report fulfils that requirement and shows the status of the Prudential Indicators at 31st March 2018. For the 2017/18 financial year the minimum reporting requirements were that members should receive the following reports:

- an annual Treasury Management Strategy in advance of the year (Council 1st March 2017)
- a mid-year Treasury Update report (Executive 27th November 2017)
- an annual report following the year describing the activity compared to the strategy (this report)

3.2 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.

3.3 In compliance with the Prudential Code treasury management reports are scrutinised by Performance Scrutiny Committee and reviewed by the Executive prior to reporting to full Council if required. Member training for the Performance Scrutiny Committee was undertaken on 23rd November 2017 to support their role in scrutinising the half yearly report. Member training for the Audit Committee on treasury management issues was undertaken during the year on 13th February 2018 in order to support their role in scrutinising the treasury management strategy and policies.

4. Summary of Performance against Treasury Management Strategy 2017/18

4.1 The full details of transactions in the year and performance against the Prudential Indicators are included at Appendices A and B.

4.2

Actual Prudential Indicators	2017/18	2016/17
Actual Capital Expenditure	39,805	27,949
Capital Financing Requirement		
General Fund	50,977	30,173
HRA	58,503	58,503
Total	**109,480**	**88,676**
Financing Costs as a proportion of Net Revenue Stream		
General Fund	13.7%	16.3%

HRA	45.6%	45.8%

4.3 The Chief Finance Officer confirms that borrowing was only undertaken for a capital purpose and the statutory borrowing limit, the Authorised Limit was not breached.

Additional borrowing of £5.75m was taken in 2017/18.

At 31st March 2018, the principal value of the Council's external debt was £81.104m (£75.354m at 31st March 2017) and that of its investments was £15.600m (£20.760m at 31st March 2017).

4.4 The small decrease in General Fund Financing costs as a % of net revenue stream in 2017/18, when compared with 2016/17, is due to the Council's change to MRP policy. The actual financing cost for the General Fund increased from the previous year due to additional borrowing.

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

4.6 Key issues to note from activity during 2017/18:

- The Council's total debt (including leases and lease-type arrangements) at 31st March 2018 was £81.663m (Appendix A section 4.4) compared with the Capital Financing Requirement of £109.480m (Appendix A section 3.5). This represents an under-borrowing position of £27.817m, which is currently being supported by internal resources. Additional long-term borrowing will be taken in future years to bring levels up to the Capital Financing Requirement, subject to liquidity requirements, if preferential interest rates are available.
- The Council's Investments at the 31st March 2018 were £15.6m (Appendix A section 4.3), which is £5.16m lower than at 31st March 2017. Average investment balances for 2017/18 were £25.3m, which was higher than estimated balances of £23.87m in the Medium Term Financial Strategy 2017-22. It should be noted that this refers to the principal amounts of investments held, whereas the investment values included in the balance sheet are based on fair value. In most cases, this will simply be equal to the principal invested, unless the investment has been impaired.
- Actual investment interest earned on balances was £110k compared to £104k estimated in the Medium Term Financial Strategy 2017-22 (Appendix A section 10.2).
- The interest rate achieved on investments was 0.67% (including the LAMS investment) which was 0.45% above the target average 7-day LIBID rate (for 2017/18 the average was 0.22%).

4.7 Risk Benchmarking

The following reports the outturn position against the security and liquidity benchmarks in the Treasury Management Strategy.

Security

- The Council's actual security risk for the portfolio as at 31st March 2018 is 0.014%, which compares with the 0.008% for the budgeted portfolio. This gives the estimated default rate on the investment counterparties which comprise the portfolio at 31st March 2018. This equates to a potential financial loss of £2,185 on the investment portfolio of £16.5m.

- Specified Investments are high security sterling investments (i.e. high credit quality) with a maturity of no more than one year. Non-specified investments are all other investments representing a potentially greater risk; however the risk is still minimal due to the stringent controls over counterparty credit quality contained within the Investment Strategy. The 2017/18 strategy set a maximum limit of 75% of the portfolio to be held in non-specified investments. At 31st March 2018, 100% of the investment portfolio was held in specified investments. The Chief Finance Officer can report that the investment portfolio was maintained within this limit throughout the year.

Liquidity

In respect of this area the Council set liquidity benchmarks to maintain:

- Liquid short term deposits of at least £3 million available with a week's notice.
- Weighted Average Life benchmark was expected to be 0.19 years (69 days).

The actual liquidity indicators at 31st March 2018 were as follows:

- Liquid short term deposits of £6.6 million as at 31st March 2018.
- Weighted Average Life of the investment portfolio was 0.25 years (93 days). This is slightly higher than the expected benchmark.

The Chief Finance Officer can report that liquidity arrangements were adequate throughout the year.

4.8 **Benchmarking**

The Council participates in the following benchmarking club:

- The Link Asset Services benchmarking club. Link Asset Services is the Council's treasury management advisors and they offer a benchmarking club for their clients. This is organised on a regional group basis. The group to which City of Lincoln belongs has 9 members within the East Midlands region.
- The latest report (March 2018) shows that City of Lincoln Council achieved a weighted average return of 0.56% on its investments (excluding the LAMS investment) compared with the model level of 0.52%, group average of 0.62% and the average for all non-metropolitan districts of 0.63%. The Council had a lower average level of funds invested during the year compared with the group average and has a lower appetite for risk than those authorities who are achieving higher returns.

- Link also provides a measure of the credit risk of the investment portfolio. The lower the credit risk score, the lower the risk of default within the portfolio.
- The Council's portfolio at 31 March 2018 had an average credit risk score which was 2.79 and was lower than the group average score of 3.23 and a slightly higher than average Weighted Average Maturity (WAM) of 93 days compared with 91 days for the group. This shows that the Council is achieving a reasonable rate of return on the funds invested, considering the short maturity of the portfolio and low level of risk.

5. Strategic Priorities
N/A

6. Organisational Impacts

6.1 The financial impacts are contained within the main body of the report and within appendices A and B.

6.2 There are no legal impacts arising from this report.

7. Risk Implications

7.1 (i) Key risks associated with the preferred approach

8. Recommendation

8.1 That Performance Scrutiny Committee notes the actual prudential indicators contained within appendices A and B and recommends to Executive for review before recommending to Council for Approval.
8.2 That Performance Scrutiny Committee notes the annual treasury management report for 2017/18 and recommends to Executive for review.

Key Decision	No
Do the Exempt Information Categories Apply?	No
Call in and Urgency: Is the decision one to which Rule 15 of the Scrutiny Procedure Rules apply?	No
How many appendices does the report contain?	2

List of Background Papers: Link Annual Stewardship Reports for 2017/18

Medium Term Financial Strategy 2017-22 and 2018-23 Prudential Indicators 2017/18 – 2019/120 and Treasury Management Strategy 2017/18 and 2018/19

Lead Officer: Sarah Hardy – Group Accountant, Technical & Exchequer
Telephone 873839

Appendix A

Annual Report on the Treasury Management Service and Actual Prudential Indicators 2017/18

1. Introduction

1.1 The Council undertakes capital expenditure on long-term assets. These activities can 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.

Capital expenditure activity is regulated by the CIPFA Prudential Code, which requires actual outturn to be reported in the following areas: -

- Capital expenditure;
- Capital Financing Requirement;
- Debt;
- Ratio of financing costs to net revenue stream.

The remaining prudential indicators are included to make the annual reporting comprehensive and to comply with the requirements of the Treasury Management Code.

1.2 Part of the Council's treasury activities is to address any borrowing need, either through borrowing from external bodies, or utilising temporary cash resources within the Council. The wider treasury activities also include managing the Council's cash flows, its previous borrowing activities and the investment of surplus funds. These activities are structured to manage risk foremost, and then optimise performance. This area of activity is regulated by the CIPFA Code of Practice on Treasury Management.

1.3 Wider information on the regulatory requirements is shown in section 11.

2. The Council's Capital Expenditure and Financing 2017/18

2.1 This forms one of the required prudential indicators and shows total capital expenditure for the year and how this was financed.

	2017/18 Actual £'000	2017/18 Revised Estimate £'000	2016/17 Actual £'000
General Fund capital expenditure	29,098	31,419	17,234
HRA capital expenditure	10,707	15,204	10,715
Total capital expenditure	**39,805**	**46,623**	**27,949**
Resourced by:			
Capital receipts	4,674	5,483	2,708
Capital grants & contributions	3,016	3,284	13,681
Direct Revenue Financing	486	361	458
Major repairs reserve	9,190	12,857	8,023
Un-financed capital expenditure (additional need to borrow)	**22,439**	**24,638**	**3,079**

2.2 Further details on 2017/18 Capital Expenditure and Financing can be found in the Financial Performance Detailed Outturn 2017/18 report elsewhere on the agenda.

3. The Council's Overall Borrowing Need

3.1 The Council's underlying need to borrow is called the Capital Financing Requirement (CFR). This figure is a gauge for the Council's debt position and represents 2017/18 and prior years' net capital expenditure that has not yet been charged to revenue or other resources.

3.2 Part of the Council's treasury activities is to address this borrowing need, either through borrowing from external bodies, or utilising temporary cash resources within the Council.

3.3 The General Fund element of the CFR is reduced each year by a statutory revenue charge (called the Minimum Revenue Provision - MRP). The total CFR can also be reduced by:

- the application of additional capital resources (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP) or depreciation.

3.4 The Council's MRP policy for 2017/18 was approved by Council on 1st March 2017 as part of the Prudential Indicators 2017/18 – 2019/20 and Treasury Management Strategy 2017/18.

3.5 The Council's CFR for the year is shown below, and represents a key prudential indicator. The CFR includes leasing schemes which increase the Council's borrowing need. No borrowing is actually required against these schemes as a borrowing facility is included in the contract.

Capital Financing Requirement General Fund	31 March 2018 Actual £'000	31 March 2018 Revised Estimate £'000	31 March 2017 Actual £'000
Opening balance 1 April	30,173	30,173	28,464
Plus un-financed capital expenditure	22,439	24,638	3,078
Finance leases	(559)	(559)	(325)
Less MRP/VRP*	(1,076)	(925)	(1,044)
Closing balance 31 March	**50,977**	**53,327**	**30,173**

Capital Financing Requirement HRA	31 March 2018 Actual £'000	31 March 2018 Revised Estimate £'000	31 March 2017 Actual £'000
Opening balance 1 April	58,503	58,503	58,503
Plus un-financed capital expenditure	0	0	0
Less MRP/VRP*	0	0	0
Closing balance 31 March	**58,503**	**58,503**	**58,503**

* includes finance lease repayments

4. Treasury Position at 31st March 2018

4.1 Whilst the Council's gauge of its underlying need to borrow is the CFR, the Chief Finance Officer and the treasury team manage the Council's actual borrowing position by either:

- borrowing to the CFR,
- choosing to temporarily utilise some flow funds instead of borrowing (under-borrowing)
- borrowing for future increases in the CFR (borrowing in advance of need).

4.2 It should be noted that the figures in this report are based on the principal amounts borrowed and invested and so may differ from those in the final accounts by items such as accrued interest (outstanding interest due to be paid and received as at 31st March), or where the carrying amount is based on fair values .

4.3 During 2017/18 the Chief Finance Officer managed the borrowing position to £81.104 million. The treasury position at the 31st March 2018 compared with the previous year was:

	31 March 2018		31 March 2017	
	Principal £'000	**Average Rate (full year)**	**Principal £'000**	**Average Rate (full year)**
Borrowing Position				
Fixed Interest Rate Debt	81,104	4.09%	75,354	4.15%
Variable Interest Rate Debt	0	N/A	0	N/A
Total Debt (borrowing) *	81,104	4.09%	75,354	4.15%
Capital Financing Requirement (borrowing only)	109,480	N/A	87,919	N/A
Over/(under) borrowing	(27,817)	N/A	(12,565)	N/A
Investment Position				
Fixed Interest Investments	9,000	0.74%	15,000	0.86%
Variable Interest Investments	6,600	0.46%	5,760	0.39%
Total Investments **	15,600	0.68%	20,760	0.64%
Net Borrowing Position	**60,344**		**54,594**	

* Excludes local Bonds & Mortgages and other long-term liabilities (e.g. finance leases)

** The interest rate given differs from the interest rate given in Paragraph 4.8 of the main report because this one is a simple average interest for the year whereas the interest rate given in paragraph is a weighted average interest rate for the year which is calculated differently. Also the rates above are for investments held at 31 March whereas the average rate of investment is for investments held during 2017/18.

4.4 The total debt position also includes other long term liabilities such as finance leases and embedded leases within service contracts. The total debt position at 31st March 2018 was £81.663 million as shown below:

	31 March 2018 Actual £'000	**31 March 2018 Revised Estimate £'000**	**31 March 2017 Actual £'000**
Gross borrowing	81,104	81,103	75,354
Other long term liabilities	559	559	757
Total External debt	**81,663**	**81,662**	**76,111**

4.5 The maturity structure of the debt portfolio was as follows:

	31 March 2018 Actual £'000	31 March 2017 Actual £'000
Under 12 months	4,311	561
12 months and within 24 months	2,000	0
24 months and within 5 years	5,000	2,500
5 years and within 10 years	5,897	5,897
10 years and above	63,896	66,396
Total	**81,104**	**75,354**

4.6 The maturity structure of the investment portfolio was as follows:

	31 March 2018 Actual £'000	31 March 2017 Actual £'000
Longer than 1 year	0	0
Under 1 year	15,600	20,760
Total	**15,600**	**20,760**

5. The Strategy for 2017/18

5.1 The Council's overall core borrowing objectives are:

- To reduce the revenue costs of debt in line with the targets set for the Chief Finance Officer by Council (see local indicators).
- To manage the Council's debt maturity profile, leaving no one future year with a high level of repayments that might cause problems in re-borrowing.
- To effect funding at the cheapest cost commensurate with future risk.
- To forecast average future interest rates and borrow accordingly i.e. short term/variable when rates are 'high', long term/fixed when rates are 'low'.
- To monitor and review the level of variable rate loans in order to take greater advantage of interest rate movements.
- To proactively reschedule debt in order to take advantage of potential savings as interest rates change. Each rescheduling exercise will be considered in terms of the effect of premiums and discounts on the General Fund and the Housing Revenue Account.
- To manage the day-to-day cash flow of the Authority in order to, where possible, negate the need for short-term borrowing. However, short-term borrowing will be incurred, if it is deemed prudent to take advantage of good investment rates.

6. Actual Debt Management Activity during 2017/18

6.1 Borrowing

6.1.1 Long term borrowing, totalling £5.75m, was taken in 2017/18

6.1.2 The average rate achieved for long-term borrowing (excluding finance and embedded leases) in 2017/18 was 4.09%, which compares favourably to the target of 4.25% (2016/17 4.15% actual compared to the target of 4.25%).

	31 March 2018 Actual £'000	**31 March 2018 Revised Estimate £'000**	**31 March 2017 Actual £'000**
Interest payable on borrowing	3,135	3,221	3,126
- General Fund	783	824	774
- HRA	2,352	2,352	2,352
Interest payable on finance leases	60	93	78
- General Fund	60	93	78
- HRA	0	0	0

6.2 Rescheduling

6.2.1 No rescheduling was undertaken during the year as the differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

7. Prudential Indicators and Compliance Issues

7.1 Some of the required prudential indicators provide either an overview or specific limits on treasury activity. These are shown below:

7.2 Net Borrowing and the CFR

7.2.1 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 2017/18 plus the expected changes to the CFR over 2018/19 and 2019/20 from financing the capital programme. 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 net borrowing position against the CFR. The Council has complied with this prudential indicator.

	31 March 2018 Actual £'000	31 March 2018 Revised Estimate £'000	31 March 2017 Actual £'000
Net borrowing position	60,344	65,703	54,594
Capital Financing Requirement	109,480	111,830	88,676

7.3 The Authorised Limit and Operational Boundary

7.3.1 The Authorised Limit is the "Affordable Borrowing Limit" required by section 3 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.

7.3.2 The Operational Boundary is the expected borrowing position of the Council during the year, and periods where the actual position is either below or over the Boundary is acceptable subject to the Authorised Limit not being breached.

7.3.3 The table below shows the highest borrowing position reached in the year (including temporary borrowing and other long term liabilities) compared to the Authorised Limit and Operational Boundary.

	2017/18 £'000
Authorised Limit	112,000
Maximum gross borrowing position during 2017/18	81,104
Operational Boundary	109,500
Average gross borrowing position during 2017/18	76,470
Minimum gross borrowing position during the year	75,354

7.4 Actual financing costs as a proportion of net revenue stream

7.4.1 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.

Financing costs as a proportion of net revenue stream -	2017/18 Actual %	2017/18 Revised Estimate %	2016/17 Actual %
General Fund	13.7%	12.6%	16.3%
HRA	45.8%	45.3%	45.8%

The small decrease in General Fund Financing costs as a % of net revenue stream in 2017/18, when compared with 2016/17, is due to the Council's change to MRP policy. The actual financing cost for the General Fund increased from the previous year due to additional borrowing.

The HRA financing cost as a % of net revenue stream in 2017/18 is materially unchanged

8. Economic Background for 2017/18

The following commentary on the economic conditions for 2017/18 is provided by Link Asset Services, the Council's treasury management advisers.

8.1 **UK.** After the UK economy surprised on the upside with strong growth in 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 has been 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 has caused, in turn, a reduction in consumer disposable income and spending power and so the services sector of the economy, accounting for around 75% of GDP, has seen weak growth as consumers cut back on their expenditure.

However, growth did pick up in quarter 3 to 0.5% before dipping back to 0.4% in quarter 4. Annual growth for 2017, therefore, came in at an overall figure of 1.8%, the same as the upwardly revised figure for 2016, (which meant the UK was equal to Germany in having the strongest GDP growth figure of the G7 countries in 2016). 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 will have a much more muted effect on the average total GDP growth figure for the UK economy as a whole.

The Monetary Policy Committee (MPC) meeting minutes of 14 September 2017 surprised markets and forecasters by using a much more aggressive tone in its words, warning that Bank Rate would need to rise shortly. CPI inflation duly peaked at 3.1% in November 2017 as the MPC had forecast, but the February 2018 MPC forecast still sees CPI above its target rate of 2% in two years' time. The primary reason why the MPC has become more aggressive with its wording around the pace of increases in Bank Rate in, and since September, is due to an emerging view that with unemployment falling to 4.3%, the lowest level since 1975, and improvements in productivity being so weak, the amount of spare capacity in the economy has also significantly diminished. In particular, the MPC has also been concerned at building pressure on rising average wage rates. It was, therefore, no surprise that the MPC increased Bank Rate by 0.25% to 0.5% in November.

Their forward guidance of two more increases of 0.25% by 2020 was viewed as being more dovish than markets had expected. Unsurprisingly then, at their February 2018 meeting, the wording became more aggressive still and indicated that Bank Rate would be going up faster than had previously been indicated to the markets. Nevertheless, while there remains so much uncertainty around the Brexit negotiations, consumer spending levels and business investment, it is still far too early to be confident about how strong growth and inflationary pressures will be over the next two years, and therefore the pace of any rate increases.

EU. Economic growth in the EU, (the UK's biggest trading partner), had been lack lustre 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. However, growth picked up in 2016 and now looks to have gathered ongoing substantial strength and momentum thanks to this stimulus, with an overall GDP figure for 2017 likely to be around 2.5%. Nevertheless, despite providing massive monetary stimulus, the ECB is still struggling to get inflation up to its 2% target and in March, inflation was 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%. Unemployment in the US has also fallen 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 started 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%. There could be a further two or more increases in 2018. In October 2017, the Fed became the first major western central bank to make a start on unwinding Quantitative Easing by phasing in a gradual reduction in respect of reinvesting maturing debt.

Chinese 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 during 2017 to reach an annual figure of 2.1% in quarter 4. 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.

Investment Position

The Council's investment policy is governed by DCLG Guidance, which has been implemented in the Annual Investment Strategy approved by Council on 1st March 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.). The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.
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 meet the expectations of the budget.

Balance Sheet Resources - General Fund	**31 March 2018 £'000**	**31 March 2017 £'000**
Balances	1,609	2,312
Earmarked reserves	7,916	5,463
Provisions	3,204	3,604
Usable capital receipts	41	3,039
Total	**12,770**	**14,418**
Balance Sheet Resources - HRA	**31 March 2018 £'000**	**31 March 2017 £'000**
Balances	1,023	1,087
Earmarked reserves	1,016	1,481
Provisions	0	0
Usable capital receipts	9,204	6,360
Total	**11,243**	**8,928**
Total General Fund & HRA	**24,013**	**23,346**

9. Investments Held by the Council

9.1 The Council does not have the expertise or resources to actively use a wide range of investment products and therefore performance tends to be more stable but lower over the longer term than for professionally managed funds (whose performance may fluctuate more). The Council maintained an average balance of £25.3m and received an average return of 0.67%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.22%. Based on the average investment balance this performance margin of 0.45% in the Council's favour.

9.2 In 2017/18, £110k interest was earned on balances (£184k in 2016/17). This is £14k more than the £96k estimated in the Medium Term Financial Strategy 2017-22. The analysis of this result is shown in the table below.

	MTFS 2017-22 Budget £'000	**Outturn 2017/18 £'000**
Interest earned - General fund	63	71
- HRA	33	39
Total interest earned	**96**	**110**
Average balance invested in year	23,870	25,363
Average interest rate achieved	0.40%	0.67%*

* The interest rate given differs from the interest rate given in Paragraph 4.8 of the main report because this one is a simple average interest for the year whereas the interest rate given in paragraph is a weighted average interest rate for the year which is calculated differently.

The Economic Background for 2017/18 (see Section 8) sets out the economic conditions during this period, resulting in still falling deposit rates, which impacted adversely on investment returns. Counterparty security remains an issue, shown by little improvement in the credit ratings for the majority of financial institutions. There remained few counterparties available to the Council for investment, however, and there has been virtually no change in yield. Lending to local authorities for longer periods has again given an enhanced return at very low risk.

10. Risk Benchmarking

The regulatory framework also requires the consideration and approval of security and liquidity benchmarks. Yield benchmarks are currently widely used to assess investment performance (i.e. rate achieved compared with the 7-day LIBID). Security and liquidity benchmarks are used to assess the level of risk in the investment portfolio and whether sufficient liquidity is being maintained.

10.1 The following reports the current position against the benchmarks originally approved in the 2017/18 Treasury Management Strategy.

Security

- The Council's security risk for the portfolio as at 31st March 2018 is 0.014%, which compares with the 0.008% for the budgeted portfolio. This gives the estimated default rate on the investment counterparties which comprise the portfolio at 31st March 2018. This equates to a potential financial loss of £2,185 on the investment portfolio of £15.6m
- Specified Investments are high security sterling investments (i.e. high credit quality) with a maturity of no more than one year. Non-specified investments are all other investments representing a potentially greater risk however the risk is still minimal due to the stringent controls over counterparty credit quality contained within the Investment Strategy. The 2017/18 strategy set a maximum limit of 75% of the portfolio to be held in non-specified investments. At 31st March 2018, 100% of the investment portfolio was held in specified investments. The Chief Finance Officer can

report that the investment portfolio was maintained within this limit throughout the year.

Liquidity

In respect of this area the Council set liquidity benchmarks to maintain:

- Liquid short term deposits of at least £3 million available with a week's notice.
- Weighted Average Life benchmark was expected to be 0.19 years (69 days).

The actual liquidity indicators at 31st March 2018 were as follows:

- Liquid short term deposits of £6.6 million as at 31st March 2018.
- Weighted Average Life of the investment portfolio was 0.25 years (93 days).

10.2 **Performance Indicators set for 2017/18**

10.3 The Code of Practice on Treasury Management requires the Council to set performance indicators to assess the adequacy of the treasury management function over the year. The Chief Finance Officer set 8 local indicators for 2017/18, which aim to add value and assist the understanding of the main prudential indicators. These indicators, detailed in Appendix B, are:

- Debt – Borrowing rate achieved against average 7 day LIBOR.
- Investments – Investment rate achieved against average 7 day LIBID.
- Average rate of interest paid on the Councils Debt during the year – this will evaluate performance in managing the debt portfolio to release revenue savings.
- The amount of interest on debt as a percentage of gross revenue expenditure.
- Limit on fixed interest rate investments
- Limit on fixed interest rate debt
- Limit on variable rate investments
- Limit on variable rate debt

Regulatory Framework, Risk and Performance

11. The Council's treasury management activities are regulated by a variety of professional codes, statutes and guidance:

- The Local Government Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;
- The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions were made in 2014/15);
- Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act;

- The SI requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities;
- The SI also requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services;
- Under the Act the ODPM has issued Investment Guidance to structure and regulate the Council's investment activities;

Under section 238(2) of the Local Government and Public Involvement in Health Act 2007 the Secretary of State has taken powers to issue guidance on accounting practices.

11.1 The Council has complied with all of the above relevant statutory and regulatory requirements, which limit the levels of risk associated with its treasury management activities. In particular its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach.

12. The Council is aware of the risks of passive management of the treasury portfolio and, with the support of Capita Asset Services, the Council's advisers, has proactively managed its treasury position over the year. The Council has continued to utilise historically low borrowing costs and has complied with its internal and external procedural requirements. There is little risk of volatility of costs in the current debt portfolio as the interest rates are predominantly fixed, utilising long-term loans.

12.1

- Shorter-term variable rates and likely future movements in these rates predominantly determine the Council's investment return. These returns can therefore be volatile and, whilst the risk of loss of principal is minimised through the annual investment strategy, accurately forecasting future returns can be difficult.

Prudential and Treasury Indicators 2016/17

1. PRUDENTIAL INDICATORS	2017/18 Actual	2017/18 Revised	2016/17 Actual
Capital Expenditure	**£'000**	**£'000**	**£'000**
General Fund	29,098	31,419	17,234
HRA	10,707	15,204	10,715
TOTAL	39,805	46,623	27,949
Ratio of financing costs to net revenue stream	**%**	**%**	**%**
General Fund	13.7%	18.0%	16.3%
HRA	45.6%	46.2%	45.8%
Borrowing requirement General Fund	**£'000**	**£'000**	**£'000**
Borrowing at 1 April	17,263	17,246	17,246
Borrowing requirement at 31 March	27,178	34,420	29,416
In-year borrowing requirement	9,915	17,174	12,170
Borrowing requirement HRA	**£'000**	**£'000**	**£'000**
Borrowing at 1 April	58,503	58,503	58,113
Borrowing requirement at 31 March	58,503	58,503	58,503
In-year borrowing requirement	0	0	390
Net Debt	**£'000**	**£'000**	**£'000**
General Fund	4,215	20,715	4,785
HRA	49,188	37,996	49,809
Total	53,403	58,711	54,594
CFR	**£'000**	**£'000**	**£'000**
General Fund	50,977	52,628	30,173
HRA	58,503	58,503	58,503
TOTAL	109,480	111,131	88,676
Annual change in Capital Financing Requirement	**£'000**	**£'000**	**£'000**
General Fund	2,845	6,713	1,709
HRA	0	0	0
TOTAL	2,845	6,713	1,709
Incremental impact of capital investment decisions	**£(20.15)**	**£(1.41)**	**£(7.03)**

Appendix B

1. PRUDENTIAL INDICATORS	2017/18 Actual	2017/18 Revised	2016/17 Actual
Increase in average housing rent per week	£(0.03)	£0.03	£0.08

2. TREASURY MANAGEMENT INDICATORS	2017/18 Actual	2017/18 Revised	2016/17 Actual
Authorised Limit for external debt –	**£'000**	**£'000**	**£'000**
Borrowing Other long term liabilities TOTAL	81,104 559 81,663	122,000 2,500 124,500	75,354 1,082 76,436
Operational Boundary for external debt -	**£'000**	**£'000**	**£'000**
Borrowing Other long term liabilities TOTAL	81,104 559 81,663	115,000 2,000 117,000	75,354 1,082 76,436
Actual external debt	**£'000**	**£'000**	**£'000**
General Fund HRA TOTAL	22,991 58,113 81,104	22,990 58,113 81,103	17,241 58,113 75,354
Upper limit for fixed interest rate exposure	**£m**	**Target £m**	**£m**
Net principal re fixed rate borrowing / investments	77.2	76.6	61.4
Upper limit for variable rate exposure	**£m**	**Target £m**	**£m**
Net principal re variable rate borrowing / investments	20.7	33.0	30.2
Upper limit for total principal sums invested for over 1 year	**£’000**	**£’000**	**£’000**
(per maturity date)	Nil	5,000	3,000

Maturity structure of fixed rate borrowing during 2017/18	Actual %	Upper limit %	Lower limit %
Under 12 months	5.32	40	0
12 months and within 24 months	2.47	40	0
24 months and within 5 years	6.16	60	0
5 years and within 10 years	7.27	80	0
10 years and above	78.78	100	10

Appendix B

Local Indicators Treasury Management Indicators

	2017/18 Actual %	2017/18 Revised %	2016/17 Actual %
Debt - Borrowing rate achieved **i.e. temporary borrowing (loans of less than 1 year)**	Achieved 0.71% Average 0.34% +0.37%	Less than 7 day LIBOR	No temporary borrowing taken during year

The indicator above uses the average of the 7 day LIBOR rate for temporary borrowing however the temporary borrowing taken during the year was for 364 days – the average LIBOR rate for 12 months is 0.73% and rates for PWLB loans for a up to 1 year were around 1.6%.

	2017/18 Actual %	2017/18 Revised %	2016/17 Actual %
Investment rate achieved	Achieved 0.67% LIBID 0.22% +0.45%	Greater than 7 day LIBID	Achieved 0.64% LIBID 0.34% +0.30%

	2017/18 Actual %	2017/18 Revised %	2016/17 Actual %
Average rate of Interest Paid on Council Debt (%)	4.09%	Less than 4.75%	4.15%

	2017/18 Actual %	2017/18 Revised %	2016/17 Actual %
Interest on Debt as a % of Gross Revenue Expenditure	**3.3%**	**3.1%**	**3.0%**
General Fund	1.23%	1.1%	1.1%
HRA	8.26%	8.0%	9.2%

	2017/18 Actual %	2017/18 Revised %	2016/17 Actual %
Upper limits on fixed interest rate investments	58%	100%	68%

	2017/18 Actual %	2017/18 Revised %	2016/17 Actual %
Upper limits on fixed interest rate debt	100%	100%	100%

	2017/18 Actual %	2017/18 Revised %	2016/17 Actual %
Upper limits on variable interest rate investments	42%	75%	32%

	2017/18 Actual %	2017/18 Revised %	2016/17 Actual %
Upper limits on variable interest rate debt	0%	40%	0%