CITY OF PLYMOUTH

Subject:	Annual Report on Treasury Management Activities for 2017/18
Committee:	Audit Committee
Date:	31st May 2018
Cabinet Member:	Councillor Lowry
CMT Member:	Andrew Hardingham (Interim Strategic Director of Transformation and Change)
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Ref:	Fin/CF
Key Decision	No
Part:	I

Purpose of the report:

In order to comply with the Code of Practice for Treasury Management, the Council is required to formally report on its treasury management activities for the year, providing information on the progress and outcomes against the Treasury Management Strategy. This report covers the treasury management activities for financial year 2017/18 including the final position on the statutory Prudential Indicators.

This report:

a) is prepared in accordance with the CIPFA Treasury Management Code and the Prudential Code;
b) confirms capital financing, borrowing, debt rescheduling and investment transactions for the year 2017/18;
c) provides an update on the risk inherent in the portfolio and outlines actions taken by the Council during the year to minimise risk;
d) gives details of the outturn position on Treasury Management transactions in 2017/18;
e) confirms compliance with treasury limits and Prudential Indicators (PIs) and the outlines the final position on the PI's for the year.

In line with the recommendations in the Code of Practice, this report is submitted to Audit Committee as the committee responsible for scrutiny of the treasury management function.

In accordance with Treasury Management Practices note 6, this report is required to be submitted to Full Council.

The Council Corporate Plan 2016/19

Effective financial management is fundamental to the delivery of corporate improvement priorities. Treasury Management activity has a significant impact on the Council's activity both in revenue budget terms and capital investment and is a key factor in facilitating the delivery against a number of corporate priorities.

Implications for Medium Term Financial Plan and Resource Implications: Including finance, human, IT and land

Into the medium and longer term the Council is facing significant pressures due to the national economic situation, which has led to a reduction in resources for local authorities over the Government's latest spending period. Effective Treasury Management will be essential in ensuring the Council's cash flows are used to effectively support the challenges ahead.

Other Implications: e.g. Child Poverty, Community Safety, Health and Safety, Risk Management and Equality:

There is an inherent risk to any Treasury Management activity. The Council continues to manage this risk by ensuring all investments are undertaken in accordance with the approved investment strategy, and keeping the counterparty list under constant review.

Recommendations & Reasons for recommended action:

1. To note the Treasury Management Annual Report 2017/18.
2. To refer the Treasury Management Annual Report 2017/18 to Full Council for approval.

   This is to comply with the CIPFA Code of Practice and discharge our statutory requirement.

Alternative options considered and reasons for recommended action:

None - it is requirement to report to Council on the treasury management activities for the year.

Background papers:

- Treasury Management Strategy report to Council 26 February 2018
- Mid-Year Review report to Audit Committee 7 December 2017

Sign off:

Fin	pl1819.07	Leg/ Dem& Gov	lt/30516/2105	HR	n/a	Corp Prop	n/a	IT	n/a	Strat Proc	n/a
Originating SMT Member: Andrew Hardingham, Service Director for Finance											
Has the Cabinet Member(s) agreed the content of the report? Yes											

Annual Report on Treasury Management Activities for 2017/18

Introduction

The Chartered Institute of Public Finance and Accountancy's Treasury Management (the CIPFA Code) requires the Council to report on the performance of the treasury management function after the financial year end).

The Council's Treasury Management Strategy for 2017/18 was approved by Council on 15 February 2017. The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Council's treasury management strategy.

External Context

Economic background: 2017-18 was characterised by the push-pull from expectations of tapering of Quantitative Easing (QE) and the potential for increased policy rates in the US and Europe and from geopolitical tensions, which also had an impact.

The UK economy latest estimates the first estimate of Q1 GDP showed the UK economy expanded by 0.1% over the quarter and 1.2% year-on-year. The quarter figure was below market expectations, while the year-on-year figure was in line with expectations.

There are concerns that the UK economy will continue to decline in preparation for the exit of the EU in 2019. This is in contrast to the international growth momentum generated by the increasingly buoyant US 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 year-on-year 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 labour market showed resilience as the unemployment rate fell back to 4.3% in January 2018. 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.

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.

In contrast, economic activity in the Eurozone gained momentum and although the European Central Bank removed reference to an ‘easing bias’ in its market communications and had yet to confirm its QE intention when asset purchases end in September 2018, the central bank appeared some way off normalising interest rates. The US economy grew steadily and, with its policy objectives of price stability and maximising employment remaining on track, the Federal Reserve Open Market Committee (FOMC) increased interest rates in December 2017 by 0.25% and again in March, raising the policy rate target range to 1.50% - 1.75%. The Fed is expected to deliver two more increases in 2018 and a further two in 2019. However, the imposition of tariffs on a broadening range of goods initiated by the US, which has led to retaliation by China, could escalate into a deep-rooted trade war having broader economic consequences including inflation rising rapidly, warranting more interest rate hikes.

Financial markets: The increase in Bank Rate resulted in higher money markets rates: 1-month, 3-month and 12-month LIBID 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.

The FTSE 100 had a strong finish to calendar 2017, reaching yet another record high of 7688, before plummeting below 7000 at the beginning of 2018 in the global equity correction and sell-off.

Credit background: In the first quarter of the financial year, UK bank credit default swaps reached three-year lows on the announcement that the Funding for Lending Scheme, which gave banks access to cheaper funding, was being extended to 2018. For the rest of the year, CDS prices remained broadly flat.
The rules for UK banks’ ring-fencing were finalised by the Prudential Regulation Authority and banks began the complex implementation process ahead of the statutory deadline of

1st January 2019. As there was some uncertainty surrounding which banking entities the Council would will be dealing with once ring-fencing was implemented and what the balance sheets of the ring-fenced and non ring-fenced entities would look would actually look like, in May 2017 Arlingclose advised adjusting downwards the maturity limit for unsecured investments to a maximum of 6 months. The rating agencies had slightly varying views on the creditworthiness of the restructured entities.
Barclays was the first to complete its ring-fence restructure over the 2018 Easter weekend; wholesale deposits including local authority deposits will henceforth be accepted by Barclays Bank plc (branded Barclays International), which is the non ring-fenced bank.

Money Market Fund regulation: The new EU regulations for Money Market Funds (MMFs) were finally approved and published in July and existing funds will have to be compliant by no later than 21st January 2019. The key features include Low Volatility Net Asset Value (LVNAV) Money Market Funds which will be permitted to maintain a constant dealing NAV, providing they meet strict new criteria and minimum liquidity requirements. MMFs will not be prohibited from having an external fund rating (as had been suggested in draft regulations). Arlingclose expects most of the short-term MMFs it recommends to convert to the LVNAV structure and awaits confirmation from each fund.

Credit Rating developments: The most significant change was the downgrade by Moody's to the UK sovereign rating in September from Aa1 to Aa2 which resulted in subsequent downgrades to sub-sovereign entities including local authorities.

Changes to credit ratings included Moody's downgrade of Standard Chartered Bank's long-term rating to A1 from Aa3 and the placing of UK banks' long-term ratings on review to reflect the impending ring-fencing of retail activity from investment banking (Barclays, HSBC and RBS were on review for downgrade; Lloyds Bank, Bank of Scotland and National Westminster Bank were placed on review for upgrade).

Standard & Poor's (S&P) revised upwards the outlook of various UK banks and building societies to positive or stable and simultaneously affirmed their long and short-term ratings, reflecting the institutions' resilience, progress in meeting regulatory capital requirements and being better positioned to deal with uncertainties and potential turbulence in the run-up to the UK's exit from the EU in March 2019. The agency upgraded Barclays Bank's long-term rating to A from A- after the bank announced its plans for its entities post ring-fencing.

Fitch revised the outlook on Nationwide Building Society to negative and later downgraded the institution's long-term ratings due to its reducing buffer of junior debt. S&P revised the society's outlook from positive to stable.
S&P downgraded Transport for London to AA- from AA following deterioration in its financial position.

Other developments: In March, following Arlingclose's advice, the Council removed RBS plc and National Westminster Bank from its counterparty list. This did not reflect any change to the creditworthiness of either bank, but a tightening in Arlingclose's recommended minimum credit rating criteria to A- from BBB+ for FY 2018-19. The current long-term ratings of RBS and NatWest do not meet this minimum criterion, although if following ring-fencing NatWest is upgraded, the bank would be reinstated on the Council's lending list.

Local Authority Regulatory Changes: 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 / are being] 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 intends to produce a Capital Strategy by December 2018.

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, must be discussed in the Capital Strategy or Investment Strategy. Additional risks of such investments are to be set out clearly and the impact on financial sustainability is be identified and reported.

MHCLG Investment Guidance and Minimum Revenue Provision (MRP): In February 2018 the MHCLG (Ministry of Housing, Communities and Local Government) 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 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.

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 Council 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 Council has met the conditions to opt up to professional status and has done so in order to maintain its erstwhile MiFID II status prior to January 2018. The Council will continue to have access to products including money market funds, pooled funds, treasury bills, bonds, shares and to financial advice.

Local Context

On 31st March 2018, the Council had net borrowing of £205m arising from its revenue and capital income and expenditure, an increase on 2017 of £45m. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors and the year-on-year change are summarised in table 1 below.

Table 1: Balance Sheet Summary

	31.3.17 Actual £m	2017/18 Movement £m	31.3.18 Actual £m
General Fund CFR	354	62	416
Less: Other debt liabilities *	-121	-4	-125
Borrowing CFR	**233**	**58**	**291**
Less: Usable reserves	-55	-8	-63
Less: Working capital	-18	-5	-23
Net borrowing	**160**	**45**	**205**

* *finance leases, PFI liabilities and transferred debt that form part of the Council's total debt*

Net borrowing has increased due to a rise in the CFR as new capital expenditure was higher than the financing applied including minimum revenue provision; together with a small decrease in usable reserves and a fall in working capital due to the timing of receipts and payments.

Borrowing Activity

At 31st March 2018, the Council held £358m of loans, (an increase of £71m on 31/03/2017) as part of its strategy for funding previous years' capital programmes. See table 2 below.

The Council's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Council's long-term plans change being a secondary objective.

Affordability and the "cost of carry" remained important influences on the Council's borrowing strategy alongside the consideration that, for any borrowing undertaken ahead of need, the proceeds would have to be invested in the money markets at rates of interest significantly lower than the cost of borrowing. As short-term interest rates have started to rise with the likelihood of further rises over the next 12 months.

The benefits of internal borrowing were monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise. Arlingclose assists the Council with this 'cost of carry' and breakeven analysis. Temporary and short-dated loans borrowed from the markets, predominantly from other local authorities, also remained affordable and attractive.

The Council's Treasury Management Board has determined it was more cost effective in the short-term to borrow short-term loans instead of fixing in at higher long term rates. The Council reviews the situation on a regular basis and also takes advice from it Treasury Management advisors.

Table 2: Borrowing Activity

	Balance on 01/04/2017 £m	Movement £m	Balance on 31/03/2018 £m	Avg Rate %
Public Works Loan Board	44	0	44	5.76%
Banks - LOBOs	82	0	82	4.38%
Banks - Fixed Long Term	18	15	33	3.03%
Short Term Borrowing	143	56	199	0.52%
TOTAL BORROWING	287	71	358	2.28%
Other Long Term Liabilities	113	12	125	-
TOTAL EXTERNAL DEBT	400	83	483	-
Increase/ (Decrease) in Borrowing £m			83	

LOBOs

The Council holds £82m (£82m in 2017) of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates. The Council then has the option to either accept the new rate or to repay the loan at no additional cost. During the year £46m of our LOBOs had options, none of which were exercised by the lender.

Future transactions: Please note that on 13th April 2018 a LOBO loan for £11m was refinanced and this will reduced the amount of LOBOs held by the Council to £71m. The Council is still pursuing other refinancing deals.

LGA Bond Agency

UK Municipal Bonds Agency (MBA) plc. was established in 2014 by the Local Government Association as an alternative to the PWLB with plans to issue bonds on the capital markets and lend the proceeds to local authorities. In early 2016 the Agency declared itself open for business, initially only to English local authorities. The Council has analysed the potential rewards and risks of borrowing from the MBA and has approved and signed the Municipal Bond Agencies framework agreement which sets out the terms upon which local authorities will borrow, including details of the joint and several guarantee.

As at 31st March 2017 no bonds have been issued by the Municipal Bonds Agency.

Debt Rescheduling

The PWLB continued to operate a spread of approximately 1% between "premature repayment rate" and "new loan" rates so the premium charge for early repayment of PWLB debt remained relatively expensive for the loans in the Council's portfolio and therefore unattractive for debt rescheduling activity. No rescheduling activity was undertaken as a consequence.

Other Long Term Liabilities

Although not classified as borrowing, the Council has other capital finance from Private Finance Initiatives and Finance Leases etc. and as at 31st March 2018 this amounted to £125m.

The liability for the PFI scheme has increased our requirement for finance and therefore we increased our Operational Boundary and Authorised limit to allow for this.

Minimum Revenue Provision (MRP)

Under regulation 27 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 SI 2003/146, as amended, local authorities are required to charge to their revenue account, for each financial year, MRP for the cost of their unfinanced capital expenditure.

Following changes in advice from CIPFA the Council changed it MRP calculations method in 2015/16 to use the annuity method. Prior years involved detailed calculations which were very prescriptive but these were replaced with a requirement that local authorities calculate an amount or MRP which they consider to be prudent.

The Council matches the economic benefits from its assets with the life of those assets. Therefore the Council changed its calculation method to the annuity method which not only spreads the cost of the borrowing over the life of the assets but it also takes into account the time value of money.

The Council's previous method of calculating MRP was to spread the cost of borrowing in a straight line over a maximum of 25 years. The current council tax payers would therefore pay a relative higher charge than council tax payers in the future. For example if an asset cost of £20m to build and has a life of 20 years then there would have been a £1m charged each year on the straight line basis. The annuity method takes into account the time of value because £1m today has a higher value (NPV) that £1m in 20 years' time.

To assist the Council in keeping a balanced budget for 2017/18 the Council used £2.170 m of capital receipt towards the MRP charge for 2017/18.

Investment Activity

The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During 2017/18, the Council's investment and cash balances ranged between £70 and £100 million due to timing differences between income and expenditure. The year-end investment position and the year-on-year change in show in table 3 below.

The Guidance on Local Government Investments in England gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles.

Table 3: Investment Activity in 2017/18

Investments	Balance on 01/04/2017 £m	Movement £m	Balance on 30/03/2018 £m	Avg Rate/Yield (%)
Short term Investments (call accounts etc.)	18	0	18	0.80%
Covered Bonds and Loans	11	0	11	0.77%
Money Market Funds	13	13	26	0.21%
Other Pooled Funds	20	5	25	3.95%
TOTAL INVESTMENTS	**62**	**18**	**80**	
Increase/ (Decrease) in Investments £m			18	

Both the CIPFA Code and government guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

During the year the Council invested £5m into a new CCLA Diversification Fund which offers higher rates of returns than the Council other short term investments.

The £20m portfolio of externally managed pooled CCLA Property Fund has generated a total return in the year of £1.046m (5.2%), income return used to support services in year. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives is regularly reviewed.

Security of capital has remained the Council's main investment objective. This has been maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy.

Counterparty credit quality was assessed and monitored with reference to credit ratings (the Council's minimum long-term counterparty rating is A across rating agencies Fitch, S&P and Moody's); for financial institutions analysis of funding structure and susceptibility to bail-in, credit default swap prices, financial statements, information on potential government support and reports in the quality financial press.

Given the increasing risk and falling returns from short-term unsecured bank investments, the Council wants to diversify into higher yielding long term asset classes.

Other Non-Treasury Holdings and Activity

Although not classed as treasury management activities, the 2017 CIPFA Code now requires the Council to report on investments for policy reasons outside of normal treasury management. This includes service investments for operational and/or regeneration as well as commercial investments which are made mainly for financial reasons. The Council also holds £63.9m of investments in directly owned property and loans to local businesses. This represents an increase of £28.5m on the previous year. A register of such investments is maintained and reviewed quarterly as part of the Council's performance reporting arrangements.

These non-treasury investments generated £2.1m of investment income for the Council after taking account of direct costs, representing a rate of return of 3.3%. This is higher than the return earned on treasury investments but reflects the additional risks to the Council of holding such investments.

Treasury Management Outturn 2017/18

Budget Income and Expenditure

Treasury Management Outturn Position 2017/18

	2017/18 Budget	2017/18 Outturn	Year End Variance
	£m	£m	£m
Interest Payable	0.903		
LOBO and other long term loans		4.387	
PWLB (Public Works Loan Board)		2.550	
Temporary loans		0.673	
Other Interest		0.265	
Recharge to Departments for Unsupported Borrowing (in accordance with business cases)		(6.920)	
Total Interest Payable	**0.903**	**0.955**	**0.052**
Interest Receivable	(1.969)		
CCLA Property Fund		(1.046)	
Money Market Fund		(0.047)	
Other External Interest		(0.693)	
Total Interest Receivable	**(1.969)**	**(1.786)**	**0.183**
Other Charges	0.0	0.009	0.009
Debt Management	(0.113)	0.437	0.550
Amortised Premiums	(0.096)	0.217	0.313
Total Other Charges	**(0.030)**	**0.663**	**0.872**
Minimum Revenue Provision	**7.637**	**7.302**	**(0.335)**
TOTAL	**6.363**	**7.134**	**0.712**

The Council's Treasury Management Outturn for the year was a deficit of £0.712m. The Council has to service additional borrowing and the investment returns remain very low.

The Treasury Management Outturn does not include the returns from the Council's investments in the purchasing of capital assets as this is included in the Place revenue outturn.

The Bank of England increased the Bank Rate by 0.25% to 0.50% in November 20017 and this was the first rate rise in ten years. The Bank of England have indicated that there will a further two rises in the next twelve months. The increase in interest rates increase the Council's Investments rates are always slow to increase but if the trends continue.

The Treasury Management budget is a held as a separate budget under the Finance Department of the Council's General Fund. Whilst interest costs are slightly less than the budget there are a number of factors that contribute to the final position. Whilst the Council not only borrows to finance capital expenditure, it also has to maintain a daily net cash surplus position. The costs of borrowing to finance invest to save capital schemes is charged to departments. The figures above include the borrowing implications of decisions to utilise the Asset Investment Fund to acquire assets to earn a revenue return which is accounted for in directorate's budgets.

The MRP differential derived as a consequence of the changes to the MRP financing policy agreed in 2017/18 has been used to offset amortised premiums and the increase in the PFI financing requirements and factored into the overall revenue outturn position to enable the Council to break even at year end.

The TM budget has also benefited from repayment of loans enabling service departments to release back to revenue provisions previously created as the risk of default was considered high.

Externally Managed Funds

The Council also has investments in cash plus bond and property funds which allow the Council to diversify into asset classes other than cash with the need to own and manage the underlying investments. The funds which are operated on a variable net asset value (VNAV) basis offer diversification of investment risk, coupled with the services of a professional fund manager; they also offer enhanced returns over the longer term but are more volatile in the short-term. All of the Council's pooled fund investments are in the respective fund's distributing share class which pay out the income generated.

Although money can be redeemed from the pooled funds at short notice, the Council's intention is to hold them for the medium-term. Their performance and suitability in meeting the Council's investment objectives are monitored regularly and discussed with Arlingclose.

Update on Investments with Icelandic Banks

In March 2017 the Iceland authorities lifted the restriction on movement of monies from the country and in June 2017 the Council received its final payment.

The original claim in 2008 against the Iceland Banks was for £13m principle and £0.746m interest and this has been paid in full with an additional sum of £0.235m of accrued interest.

Compliance with Prudential Indicators

The Council confirms compliance with its Prudential Indicators for 2017/18, which were set in February 2017.

The Following indicators are set and monitored each year:

- Estimates of Capital Expenditure;
- Estimates of Capital Financing Requirement;
- Gross Debt and the Capital Financing Requirement;
- Operation Boundary for External Debt;
- Authorised Limit for External Debt;
- Ratio of Financing Costs to Net Revenue Stream ;
- Incremental Impact of Capital Investment Decisions.

Treasury Management Indicators

The Council measures and manages its exposures to treasury management risks using the following indicators.

Interest Rate Exposures: This indicator is set to control the Council's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of net principal borrowed will be:

	2017/18 Limit	2017/18 Actual	Complied
Upper limit on fixed interest rate exposure	210%	57%	✓
Upper limit on variable interest rate exposure	80%	72%	✓

Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole financial year or more. Instruments that mature during the financial year are classed as variable rate.

Maturity Structure of Borrowing: This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

	Upper Limit	Lower Limit	31.03.2018 Actual	Complied
Under 12 months	100%	0%	56%	✓
12 months and within 24 months	100%	0%	5%	✓
24 months and within 5 years	100%	0%	0%	✓
5 years and within 10 years	100%	0%	0%	✓
10 years and above	100%	0%	39%	✓

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

Principal Sums Invested for Periods Longer than 365 days: The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total principal sum invested to final maturities beyond the period end will be:

	2017/18	2018/19	2019/20
Limit on principal invested beyond year	£40m	£35m	£35m
Actual	£0m	£0m	£0m
Complied	✓	✓	✓

Security: The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment.

	Target	Actual	Complied
Portfolio average credit rating	A	AA-	✓

Liquidity: The Council does not keep large amounts of cash in call accounts so that it reduces the cost of carrying excess cash. To mitigate the liquidity risk of not having cash available to meet unexpected payments the Council has access to borrow additional, same day, cash from other local authorities.

Investment Training

Officers have undergone the following training during the year:

Arlingclose – Review of Minimum Revenue Provision.
Arlingclose – Principles of Treasury Management Workshop.
CCLA – Investments Seminar
Arlingclose – Review of Borrowing and Investments.
Arlingclose - Accounts closedown workshop 2017/18.
Grant Thornton - Accounts Closedown Workshops for Local Authority Accountants

Prudential Indicators 2017/18

The Local Government Act 2003 requires the Council to have regard to CIPFA's *Prudential Code for Capital Finance in Local Authorities* (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Council has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

This report compares the approved indicators with the outturn position for 2017/18. Actual figures have been taken from or prepared on a basis consistent with, the Council's statement of accounts.

Capital Expenditure: The Council's capital expenditure and financing may be summarised as follows.

Capital Expenditure and Financing	2017/18 Estimate £m	2017/18 Actual £m	Difference £m
General Fund	155.230	98.963	56.267
Total Expenditure	**155.230**	**98.963**	**56.267**
Capital Receipts	8.510	4.827	3.683
Grants & Contributions	37.350	29.731	7.619
Reserves	0.0	0.100	0.100
Revenue	0.930	0.295	0.635
Borrowing	108.440	64.010	44.430
Total Financing	**155.230**	**98.963**	**56.267**

Capital Financing Requirement: The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose.

Capital Financing Requirement	**31.03.18 Estimate £m**	**31.03.18 Actual £m**	**Difference £m**
General Fund	**410.930**	**417.924**	6.994
Total CFR	**410.930**	**417.924**	**6.994**

The CFR rose by £64m in the year (2017 £354m) from capital expenditure financed by debt outweighs resources put aside for debt repayment.
The increase in CFR shows that the Council is increasing its borrowing to pay for capital expenditure in the city.

Gross Debt and the Capital Financing Requirement: In order to ensure that over the medium term debt will only be for a capital purpose, the Council should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence.

Actual Debt: The Council's actual debt at 31 March 2018 was as follows:

Debt	**31.03.17 Estimate £m**	**31.03.18 Actual £m**	**Difference £m**
Borrowing	288	358	70
PFI liabilities & other Finance leases	125	125	(0)
Total Debt	**413**	**483**	**70**

The actual debt levels are monitored against the Operational Boundary and Authorised Limit for External Debt below.

Operational Boundary for External Debt: The operational boundary is based on the Council's estimate of most likely (i.e. prudent, but not worst case) scenario for external debt. It links directly to the Council's estimates of capital expenditure, the capital financing requirement and cash flow requirements, and is a key management tool for in-year monitoring. Other long-term liabilities comprise finance lease, Private Finance Initiative and other liabilities that are not borrowing but form part of the Council's debt.

Operational Boundary	31.03.18 Boundary £m	31.03.18 Actual Debt £m	Complied
Borrowing	425	358	✓
Other long-term liabilities	130	125	✓
Total Debt	**555**	**483**	✓

Authorised Limit for External Debt: The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003

It is the maximum amount of debt that the Council can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

Authorised Limit	31.03.18 Boundary £m	31.03.18 Actual Debt £m	Complied
Borrowing	450	358	✓
Other long-term liabilities	160	125	✓
Total Debt	**610**	**483**	✓

Recommendations

1. To note the Treasury Management Annual Report 2017/18.
2. To refer the Treasury Management Annual Report 2017/18 to Council for approval.