

# APPENDIX A

## **Annual Treasury Management Review 2017/18 – North Hertfordshire District Council**

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April 2018

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# Annual Treasury Management Review 2017/18

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## 1. Introduction

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).

During 2017/18 the minimum reporting requirements were that the full Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 09/02/2017)
- a mid-year (minimum) treasury update report (Council 21/11/2017)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

In addition, Cabinet has received quarterly treasury management update reports.

The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is, therefore, important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members.

This Council 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 Finance Audit and Risk Committee before they were reported to the full Council.

## 2. The Economy and Interest Rates

During the calendar year of 2017, there was a major shift in expectations in financial markets in terms of how soon Bank Rate would start on a rising trend. After the UK economy surprised on the upside with strong growth in the second half of 2016, growth in 2017 was disappointingly weak in the first half of the year which meant that growth was the slowest for the first half of any year since 2012. The main reason for this was the sharp increase in inflation caused by the devaluation of sterling after the EU referendum, feeding increases into the cost of imports into the economy. This caused a reduction in consumer disposable income and spending power as inflation exceeded average wage increases. Consequently, the services sector of the economy, accounting for around 75% of GDP, saw weak growth as consumers responded by cutting back on their expenditure. However, growth did pick up modestly in the second half of 2017. Consequently, market expectations during the autumn, rose significantly that the MPC would be heading in the direction of imminently raising Bank Rate. The minutes of the MPC meeting of 14 September indicated that the MPC was likely to raise Bank Rate very soon. The 2 November MPC quarterly Inflation Report meeting duly delivered by raising Bank Rate from 0.25% to 0.50%.

The 8 February MPC meeting minutes then revealed another sharp hardening in MPC warnings on a more imminent and faster pace of increases in Bank Rate than had previously been expected. Market expectations for increases in Bank Rate, therefore, shifted considerably during the second half of 2017-18 and resulted in **investment rates** from 3 – 12 months increasing sharply during the spring quarter.

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**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 0.25% 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.

The major UK landmark event of the year was the inconclusive result of the **general election** on 8 June. However, this had relatively little impact on financial markets.

### 3. Overall Treasury Position as at 31 March 2018

During 2017/18, the Council complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

Prudential and treasury indicators	2016/17 Actual £'000	2017/18 Forecast £'000	2017/18 Actual £'000
Capital expenditure	5,686	8,465	9,382
Capital Financing Requirement:	-16,6	-2,4	-10,2
External debt	480	455	455
Investments			
• Longer than 1 year	7,000	0	1,000
• Under 1 year	29,000	17,000	29,500
• Total	36,000	17,000	30,500
Net borrowing	-35,520	-16,565	-30,045

Capital spend increased during the year from an original budget of £8.465M to an actual of £9.382M. This was mainly due to the revision in the timetable for completion of schemes from 16/17 although there were also schemes that were delayed from 2017/18 in to 2018/19.

Other prudential and treasury indicators are to be found in the main body of this report. The Head of Finance, Performance and Asset Management also confirms that no borrowing was undertaken for a capital purpose and the statutory borrowing limit, (the authorised limit), was not breached.

## 4. The Strategy for 2017/18

The strategy in 2017/18 was to continue only lending to UK banks, building societies, money market funds, Local Authorities and property funds. Only UK banks with a credit rating, for longer term deals, greater than “BBB” and F3 or above for short term credit ratings were on the Council’s lending list. (These are Fitch definitions of ratings). Not all building societies are credit rated but this did not preclude them from the lending list as lending to a building society was dependant on their asset size. Where a society did have a rating, this was considered at the time of the deal taking into account the amount of investment and the length of the deal. As well as imposing maximum limits with each counter party, the overall percentage of outstanding investments with each counterparty was assessed to ensure a reasonable spread of investments.

**Change in strategy during the year** – the strategy adopted in the original Treasury Management Strategy Report for 2017/18, approved by the Council on 09/02/2017, was not changed during the year.

## 5. The Borrowing Requirement and Debt

The Council’s underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).

This figure is a gauge of the Council’s indebtedness. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represents the 2017/18 unfinanced capital expenditure (see above table), and prior years’ net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

Part of the Council’s treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council’s cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies, (such as the Government, through the Public Works Loan Board [PWLB] or the money markets), or utilising temporary cash resources within the Council.

**Reducing the CFR** – the Council’s underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council has a negative CFR so is not required to make an annual revenue charge, called the Minimum Revenue Provision – MRP, to reduce the CFR. MRP is effectively a repayment of the borrowing need. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

The total CFR can also be reduced by:

- the application of additional capital financing resources, (such as unapplied capital receipts); or
  - charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).
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The Council's 2017/18 MRP Policy, (as required by CLG Guidance), was approved as part of the Treasury Management Strategy Report for 2017/18 on 09/02/2017. Because the Council has a negative CFR there is no requirement currently to make an annual revenue charge (MRP).

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

CFR: General Fund	31 March 2017 Actual £'000	31 March 2018 Actual £'000
Opening balance	-18,767	-16.60
Add unfinanced capital expenditure (as above)	2.185	6.39
Less MRP/VRP	0	0
Less Finance Lease repayments	0.013	<b>0.013</b>
Closing balance	-16.60	<b>-10.2</b>

Borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit.

**Gross borrowing and the CFR** - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2017/18) plus the estimates of any additional capital financing requirement for the current (2018/19) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs if required. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

	31 March 2017 Actual £'000	31 March 2018 Budget £'000	31 March 2018 Actual £'000
Gross borrowing position	.480	.455	455
CFR	-16,634	-2,427	-10,243

The CFR is negative as the Council has more cash investments than borrowing. Borrowing is historic and was undertaken prior to the housing stock transfer when the CFR was positive.

**The authorised limit** - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, 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.

**The operational boundary** – the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary is acceptable subject to the authorised limit not being breached. This boundary was not exceeded at any point during the year.

**Actual financing costs as a proportion of net revenue stream** - this indicator is the net cost of borrowing as a percentage of the total revenue budget. This would usually show how much of the overall budget is spent on borrowing costs. However as the Council's investment income exceeds the cost of interest on borrowing it is a negative number.

	2017/18 £'000
Authorised limit	6,000
Maximum gross borrowing position	480
Operational boundary	4,000
Average gross borrowing position	470
Financing costs as a proportion of net revenue stream	-2.3%

At the end of 2017/18 the Council's treasury position was as follows:

	31 March 2017 Principal £'000	Rate/ Return	31 March 2018 Principal £'000	Rate/ Return
Fixed rate borrowing:				
-PWLB	480	9.43%	455	9.59%
-Market	0		0	
Variable rate borrowing:				
-PWLB	0		0	
-Market	0		0	
<b>Total debt</b>	<b>480</b>	<b>9.43%</b>	<b>455</b>	<b>9.59%</b>
<b>CFR</b>	<b>-16.6</b>		<b>-16.6</b>	
<b>Over / (under) borrowing</b>	<b>17.08</b>		<b>17.08</b>	
Investments:				
- in house	7,500	0.66%	12,500	0.90%
- with managers	28,500	1.15%	18,000	1.17%
<b>Total investments</b>	<b>36,000</b>	<b>1.12%</b>	<b>30,500</b>	<b>1.13%</b>

The maturity structure of the debt portfolio was as follows:

	31 March 2017 Actual £'000	31 March 2017 Actual £'000
Under 12 months	25	16
12 months and within 24 months	16	17
24 months and within 5 years	53	55
5 years and within 10 years	97	92
10 years and above	289	275

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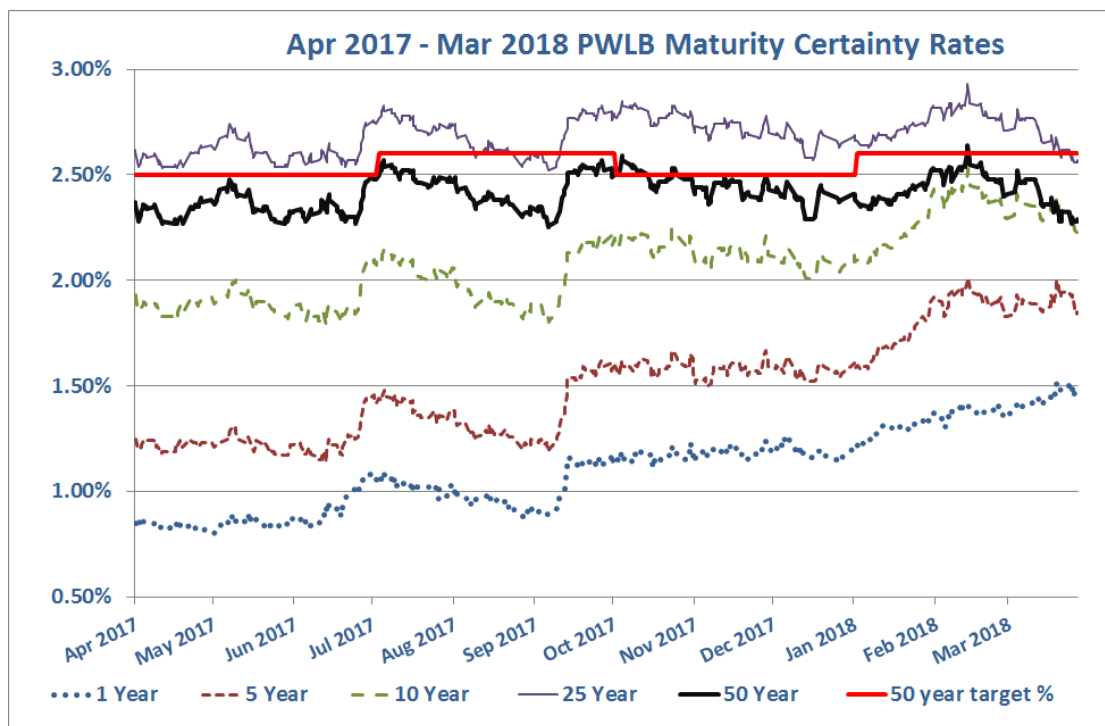
## 6. Borrowing Rates in 2017/18

### PWLB certainty maturity borrowing rates

As depicted in the graph and tables below, PWLB 25 and 50 year rates have been volatile during the year with little consistent trend. However, shorter rates were on a rising trend during the second half of the year and reached peaks in February / March.

During the year, the 50 year PWLB target (certainty) rate for new long term borrowing was 2.50% in quarters 1 and 3 and 2.60% in quarters 2 and 4.

The graphs for PWLB rates show, for a selection of maturity periods, the average borrowing rates, the high and low points in rates, spreads and individual rates at the start and the end of the financial year.



## 7. Borrowing Outturn for 2017/18

### Borrowing

No new loans were taken during the year.

£25K of PWLB loans were repaid during the year

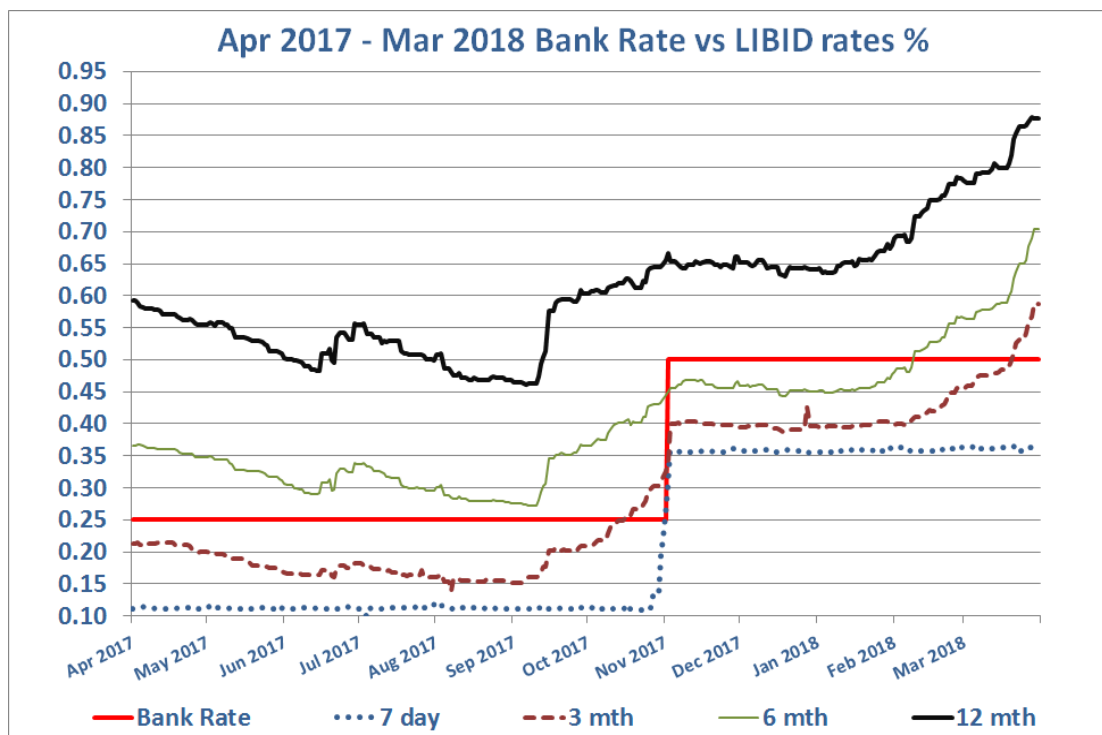
### Rescheduling

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



## 8. Investment Rates in 2017/18

Investments rates for 3 months and longer have been on a rising trend during the second half of the year in the expectation of Bank Rate increasing from its floor of 0.25%, and reached a peak at the end of March. Bank Rate was duly raised from 0.25% to 0.50% on 2.11.17 and remained at that level for the rest of the year. However, further increases are expected over the next few years. Deposit rates continued into the start of 2017/18 at previous depressed levels due, in part, to a large tranche of cheap financing being made available under the Term Funding Scheme to the banking sector by the Bank of England; this facility ended on 28.2.18.



## 9. Investment Outturn for 2017/18

**Investment Policy** – the Council’s investment policy is governed by MHCLG guidance, which has been implemented in the annual investment strategy approved by the Council on 09/02/17. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the Fitch credit rating agency for banks and asset size for building society investments.

The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties. However, there were a couple of breaches to “investing no more than 10% of outstanding investments with one counter party”. An existing investment was renewed with National Counties Building Society on 20th March for £1.5M and although the total invested with them remained unchanged, this was slightly over the 10% limit at 11.01%. Also two investments were placed with other Local Authorities in March that were over the 10% limit. £4.0M with Telford and Wrekin Council at 11.9% and Slough Borough Council at 12.4%.

**Investments placed by Cash Managers** – the Council used an external cash manager to invest its longer term cash balances. At the start of the year, Tradition had £28.5m of outstanding investments. This reduced to £18.0m by the end of the year as investments were returned to finance Capital expenditure. The performance of the Tradition against the benchmark return was:

Cash Manager	Investments Placed	Interest	Return	Benchmark*
Tradition	£28.5M - £18.0M	£0.281M	1.17%	0.30%

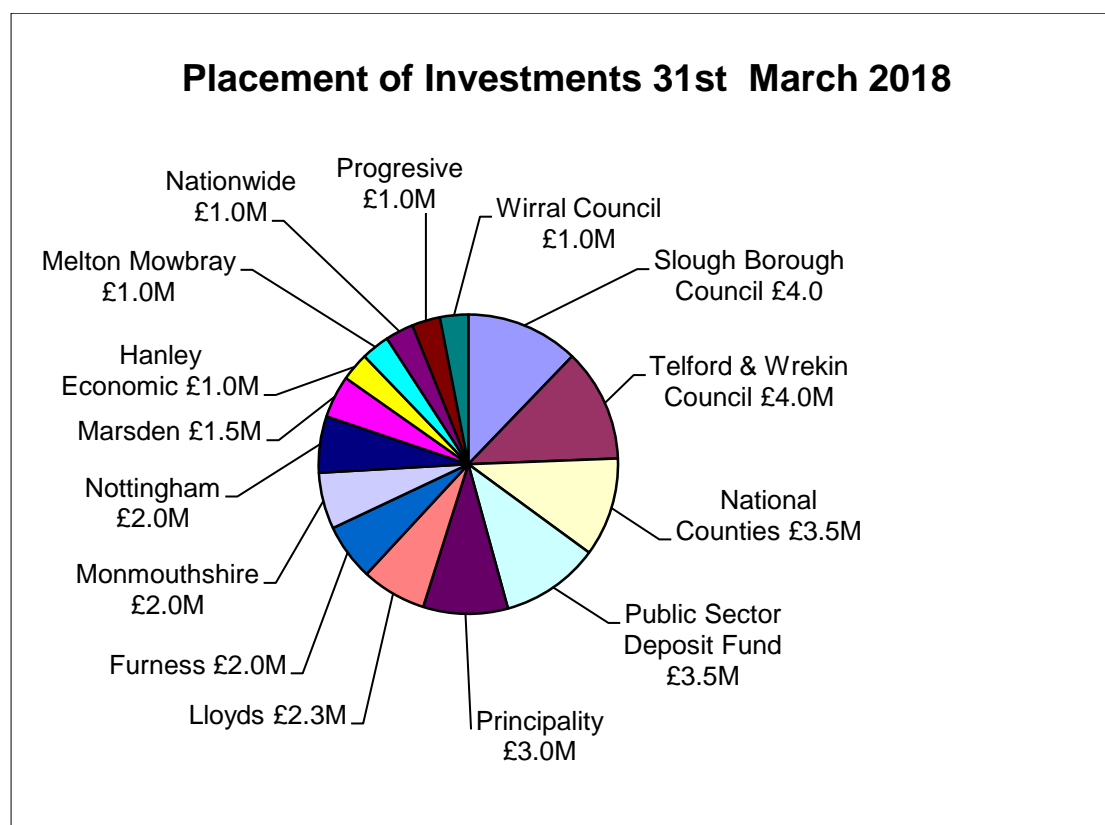
\* Ave 7 days notice Rate 0.3%

This compares with an original budget of £0.228M.

The table below summaries where investments were held at 31 March and includes the Lloyds Bank interest bearing current account:

	Investments 31 March 2016 £'000	Investments 31 March 2017 £'000
Banks	13,400	2,300
Building Societies	20,500	18,000
Local Authorities	-	9,000
Money Market Funds	5,000	3,500
<b>Total</b>	<b>38,900</b>	<b>32,800</b>

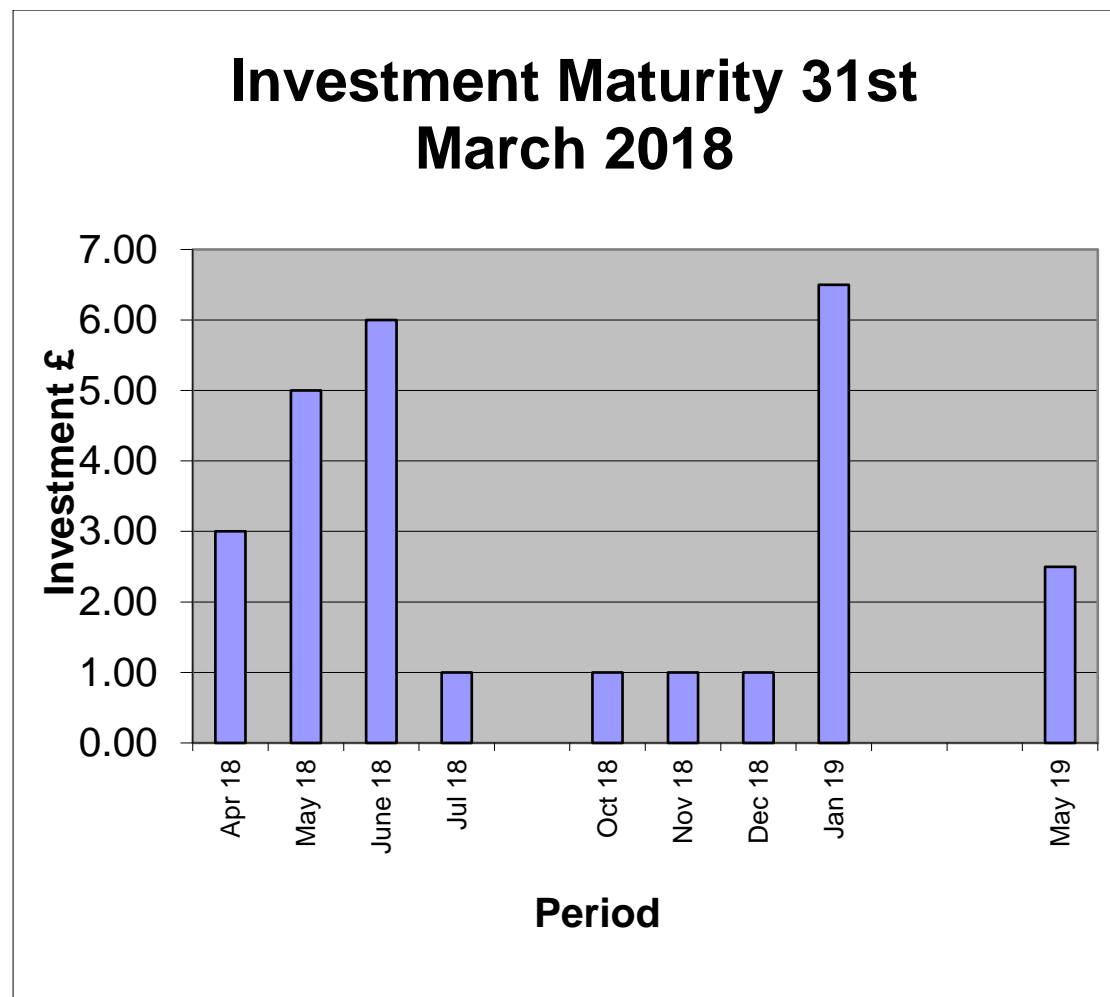
The pie chart below shows the spread of investment balances as at 31 March 2018. This is a snapshot in time that demonstrates the diversification of investments.



The average daily balance of investments was £42.2m with balances varying between £31.0m and £49.2m.

£0.334m of interest was generated from investments during the year. This is slightly more than the estimated interest of £0.320m.

The graph below shows the maturity profile of investments at 31st March 2018.



## 10. Other Issues

### 1. Revised CIPFA Codes

In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued a revised Treasury Management Code and Cross Sectoral Guidance Notes, and a revised Prudential Code.

A particular focus of these revised codes was how to deal with local authority investments which are not treasury type investments e.g. by investing in purchasing property in order to generate income for the Authority at a much higher level than can be attained by treasury investments. One recommendation was that local authorities should produce a new report to members to give a high level summary of the overall capital strategy and to enable members to see how the cash resources of the Authority have been apportioned between treasury and non-treasury investments. Officers will report to members when the implications of these new codes have been assessed as to the likely impact on this Authority.

## **2. Markets in Financial Instruments Directive II (MiFID II)**

The EU set the date of 3 January 2018 for the introduction of regulations under MIFID II. These regulations govern the relationship that financial institutions conducting lending and borrowing transactions will have with local authorities from that date. This has had little effect on this Authority apart from having to fill in forms sent by each institution dealing with this Authority and for each type of investment instrument we use, apart from for cash deposits with banks and building societies.

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