ARGYLL AND BUTE COUNCIL	**COUNCIL**
STRATEGIC FINANCE	**28 JUNE 2018**

ANNUAL TREASURY REPORT 2017-18

1. EXECUTIVE SUMMARY

1.1 This report outlines the Council's Treasury Management position for 2017-18.

1.2 The Council is required by regulations issued under the Local Government in Scotland Act 2003 to produce an annual review of treasury management activities and the actual prudential and treasury indicators and submit this to Council. The report at Appendix 1 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).

1.3 The economic and interest rate commentaries included within the Annual Treasury Report are provided by the Council's Treasury Advisors, Link Asset Services, to assist in the consideration of the Council's treasury performance.

1.4 The key points to note from the annual report are:

- Reporting requirements under the Code were met during 2017-18.
- During 2017-18 the Council's External Borrowing Increased by £8m from £170.5m at 31 March 2017 to £178.5m at 31 March 2018. The increase was due to new borrowing from the Public Works Loans Board (PWLB) of £20.0m at historically low interest rates. This was offset by repayments of £8.9m to the PWLB and a reduction in temporary borrowing of £3.1m.
- Investments at 31 March 2018 were £70m at an average rate of 0.670% compared to £64m at an average rate of 0.660% for 31 March 2017.
- The average investment rate for 2017-18 was 0.554% compared to the average 7 day LIBID rate of 0.214%.The investments generated £0.425m of income.
- The Asset Management Fund was invested in an enhanced Money Market Fund during 2017-18 to increase the rate of return while future long term investment of the fund is being assessed. The return on the fund was £15,302 a rate of return of 0.756%.

1.5 In addition to the points noted above, the annual report provides information on the capital financing requirement in Section 3. The Capital Financing Requirement (excluding NPDO commitments) was £177.802m as at 31 March 2018 and this is £0.685m lower that the Council's external debt, resulting in the Council being in an over borrowed position at the end of the financial year. The reason for being in an over-borrowed position is that there was unexpected slippage in the Council's capital plan at the year end and borrowing had already been taken out during the year, at very advantageous rates, predicated based on the budgeted capital expenditure. The over-borrowing will correct itself once the expenditure which slipped is spent during

2018-19.

1.6 Management of the debt portfolio resulted in a decrease in the average interest rate of 0.3% due to an increase in long term borrowing which generated a saving in loans charges. Over the last 2-3 years there have been savings within loans charges due to a number of reasons and it was agreed as part of the budget to make special repayments of principal in order to reduce the Council's loans charges in the future. Due to the level of unallocated General Fund balance and the risks associated with the financial position of the Health and Social, £0.500m of special repayments have been deferred and this underspend will be transferred to the General Fund balance.

2. RECOMMENDATIONS

2.1 Council are asked to approve the Annual Treasury Management Report.

3. IMPLICATIONS

3.1 Policy – None

3.2 Legal – None

3.3 Human Resources – None

3.4 Financial – None

3.5 Equal Opportunities – None

3.6 Risk – None

3.7 Customer Service – None

Kirsty Flanagan, Head of Strategic Finance
Gary Mulvaney Policy Lead for Strategic Finance

For further information please contact Peter Cupples, Finance Manager – Corporate Support 01546-604183

Appendix 1 – Annual Treasury Report 2017-18

Appendix 1

ANNUAL TREASURY REPORT

2017-2018

1. Introduction

This Council is required by regulations issued under the Local Government in Scotland 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 or the Policy and Resources Committee should receive the following reports:

- an annual treasury strategy in advance of the year (Council 23 February 2017)
- a mid-year (minimum) treasury update report (Policy and Resources Committee 8 December 2017)
- an annual review following the end of the year describing the activity compared to the strategy (this report).

In addition, the Policy and Resources Committee has received treasury management update reports on 17 August 2017, 19 October 2017 and 15 February 2018.

The regulatory environment places responsibility 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.

This Council also confirms that it has complied with the requirement under the Code to give scrutiny to all of the above treasury management reports by the Policy and Resources Committee.

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.

PWLB borrowing rates increased correspondingly to the above developments with the shorter term rates increasing more sharply than longer term rates. In addition, UK gilts have moved in a relatively narrow band this year, (within 25 bps for much of the year), compared to **US treasuries**. During the second half of the year, there was a noticeable trend in treasury yields being on a rising trend with the Fed raising rates by 0.25% in June, December and March, making six increases in all from the floor. The effect of these three increases was greater in shorter terms around 5 year, rather than longer term yields.

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

At the beginning and the end of 2017-18 the Council's treasury (excluding borrowing by PFI and finance leases) position was as follows:

	31 March 2017 Principal	Rate/ Return	Average Life yrs	31 March 2018 Principal	Rate/ Return	Average Life yrs
Total debt	***£171m***	***5.0%***	***33.7***	***£178m***	***4.7%***	***35.1***
CFR	***£180m***			***£177m***		
Over / (under) borrowing	***(£9m)***			***£1m***		
Total investments	***£64m***	***0.7%***		***£70m***	***0.7%***	
Net debt	**£107m**			**£108m**		

The Council was over borrowed at the 31 March 2018 as a result of slippage of expenditure in the capital programme during 2017-18 resulting in borrowing exceeding the CFR by £0.685m.

4. The Strategy for 2017-18

The expectation for interest rates within the treasury management strategy for 2017-18 anticipated that Bank Rate would not start rising from 0.25% until quarter 2 2019 and then only increase once more before 31 March 2020. There would also be gradual rises in medium and longer term fixed borrowing rates during 2017-18 and the two subsequent financial years. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period. Continued uncertainty in the aftermath of the 2008 financial crisis promoted a cautious approach, whereby investments would continue to be dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

In this scenario, the treasury strategy was to postpone borrowing to avoid the cost of holding higher levels of investments and to reduce counterparty risk.

During 2017-18, longer term PWLB rates were volatile but with little overall direction, whereas shorter term PWLB rates were on a rising trend during the second half of the year.

5. The Borrowing Requirement and Debt

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

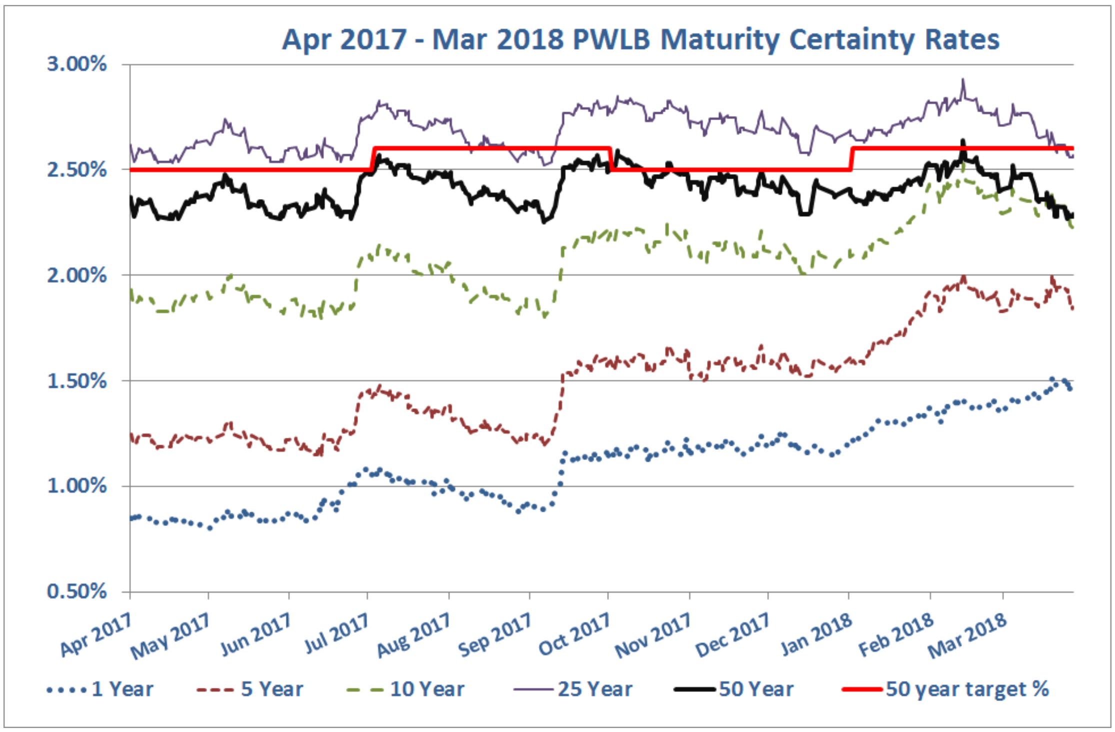
	31st March 2017 Actuals £M	**31st March 2018 Budget £M**	**31st March 2018 Actuals £M**
CFR - General Fund	254	304	306
Less NPDO	74	124	128
Net CFR	180	180	178

6. Borrowing Rates in 2017-18

Public Works Loans Board (PWLB) certainty maturity borrowing rates
As depicted in the graph 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 – the following long term loans were taken during the year: -

Lender	Principal	Type	Interest Rate	Maturity
PWLB	£10m	Fixed Interest Rate	2.38%	50 years
PWLB	£10m	Fixed Interest Rate	2.40%	50 years

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

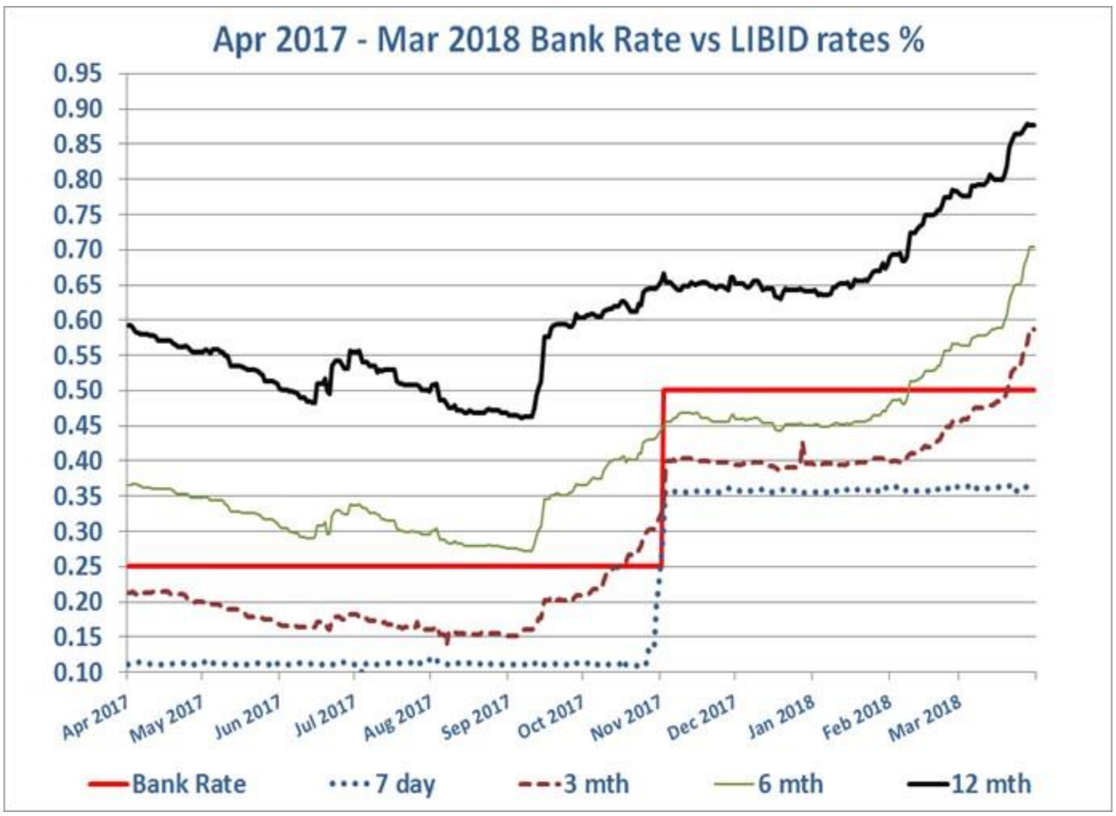
Repayments
The Council repaid the following long term loans during the year using investment balances.

Lender	Principal	Type	Interest Rate
PWLB	£0.33 m	Fixed Interest Rate	9.88%
PWLB	£0.63m	Fixed Interest Rate	10.25%
PWLB	£0.81m	Fixed Interest Rate	10.50%
PWLB	£2.41m	Fixed Interest Rate	9.50%
PWLB	£0.87m	Fixed Interest Rate	9.75%
PWLB	£0.87m	Fixed Interest Rate	9.88%
PWLB	£3.00m	Fixed Interest Rate	3.84%

Summary of debt transactions
Management of the debt portfolio resulted in a decrease in the average interest rate of 0.3% due to an increase in long term borrowing and this has contributed to savings in loans charges in 2017-18. Savings of £0.500m have been reported and transferred to the General Fund and the remaining underspend has be used to make special repayments of principal thereby reducing the budget required in future years, as agreed at budget setting time.

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 November 2017 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 February 2018.



9. Investment Outturn 2017-18

Investment Policy – the Council's investment policy is governed by Scottish Government investment regulations which have been implemented in the annual investment strategy approved by the Council on 23 February 2017. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc.).

The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

Investments held by the Council - the Council maintained an average daily balance of £76.6m of internally managed funds. The internally managed funds earned an average rate of return of 0.554%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.215%. This generated £0.425m of interest in 2017-18.

Asset Management Fund – the Council invested the £2m Asset Management Fund in an enhanced Money Market Fund during 2017-18 to increase the rate of return while future long term investment of the fund is being assessed. The return on the fund was £15,302 a rate of return of 0.765%.

10. Prudential and Treasury Indicators

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:

Actual prudential and treasury indicators	2016-17 Actual £000	2017-18 Original £000	2017-18 Actual £000
Capital expenditure	25,861	57,710	65,353
Capital Financing Requirement	253,910	304,627	306,433
Gross borrowing	244,562	277,549	307,118
External debt	170,550	153,490	178,487
Investments	63,722	53,000	69,915
Net borrowing	106,828	100,490	108,572

All investments were for less than one year, in line with the investment strategy.

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 (2015-16) plus the estimates of any additional capital financing requirement for the current (2016-17) 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 in 2017-18.

The authorised limit – this Council has kept within its authorised external borrowing limit as shown by the table above.

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.

Actual financing costs as a proportion of net revenue stream - 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.

	2017-18
Authorised limit	£341m
Maximum gross borrowing position	£246m
Operational boundary	£333m
Average gross borrowing position	£240m
Financing costs as a proportion of net revenue stream	7.4%

The maturity structure of the debt portfolio was as follows:

	31st March 2017 Actual	2017/18 Original Limits	31st March 2018 Actual
Under 12 months	£12.6m	£53.5m	£6.0m
12 months and within 24 months	£5.5m	£53.5m	£6.4m
24 months and within 5 years	£11.9m	£53.5m	£11.4m
5 years and within 10 years	£5.9m	£71.4m	£0.0m
10 years and within 20 years	£7.0m	£142.8m	£7,09m
20 years and within 30 years	£5.8m	£142.8m	£5.8m
30 years and within 40 years	£33.8m	£142.8m	£33.8m
40 years and within 50 years	£57m	£142.8m	£77.0m
50 years +	£31m	£142.8m	£31.0m
Total	£170.5m	£946.0m	£178.49m

The Council's exposure to fixed and variable interest rates in respect of borrowing was as follows which demonstrates that at the year-end the proportion of fixed and variable borrowing was within the agreed limits:

	31 March 2017 Actual	2017-18 Original Limits	31 March 2018 Actual
Fixed rate (principal or interest) based on net debt	119%	190%	118%
Variable rate (principal or interest) based on net debt	42%	60%	47%