Mole Valley District Council

Agenda Item 7

Report considered by Audit Committee on 26th July 2018

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Ward(s) affected	The annual report covers the whole District

Subject	Treasury Management – Annual Report and Prudential Indicators – 2017/18

RECOMMENDATIONS

That Audit Committee is asked to recommend to Council;

1. That the Treasury Management Annual Outturn report for 2017/18 be noted.
2. That the actual Prudential Indicators reported for 2017/18, as detailed in Appendix A to this report, be approved.

EXECUTIVE SUMMARY

Treasury management is the control and management of all the Council's cash, regardless of its source. It covers management of the daily cash position, investments and borrowings. Officers carry out this function within the parameters set by the Council each year in the Treasury Management Strategy Report.

This report reviews the performance of the Prudential Indicators and Treasury Management Strategy and Annual Plan 2017/18 as agreed by Council on 21st February 2017.

The report meets the requirements of both the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code). The Council is required to comply with both Codes through Regulations issued under the Local Government Act 2003. The primary requirements of the Codes are the:

- Creation and maintenance of a Treasury Management Policy Statement (TMPS) that sets out the policies and objectives of the Council's treasury management activities.
- Creation and maintenance of Treasury Management Practices (TMPs) that set out the manner in which the Council will seek to achieve those policies and objectives.
- Receipt by Council of an annual strategy report (21/02/17) for the year, a mid-year treasury update report (20/02/18) and a subsequent annual review

report (this report) after the end of the financial year.

The regulatory environment places a much greater 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 management activities and highlights compliance with the Council's policies previously approved by Members.

Council have delegated the responsibilities for implementing and monitoring treasury management policies and practices to the Audit Committee and for the operation and administration of treasury management decisions to the Deputy Chief Executive (Section 151 Officer), who will act in accordance with the organisation's Treasury Management Policy Statement and TMP's, and CIPFA's Standard of Professional Practice on Treasury Management.

The 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 Audit Committee before they were reported to Council.

In summary, the Council's in-house team together with some externally managed funds achieved a rate of return on investments of 1.61%. The Council achieved an overall return of £374,093 in 2017/18 approximately £49,000 above budget. Investment balances at balance sheet dates decreased from £17.542m (31/03/17) to £13.706m (31/03/18). The 2017/18 financial year continued the challenging environment of previous years with low investment returns and continuing counterparty risk.

The Council borrowed £40m from the Public Works Loans Board (PWLB) during 2017/18.

In conducting the treasury management activities of the Council there were no breaches of the agreed Strategy and the in-house team operated within the Prudential Indicators set by Council.

CORPORATE PRIORITY OUTCOMES

This report is an update on the Council's Prudential Indicators and treasury operations as contained in the Treasury Management Strategy for 2017/18.

1. BACKGROUND/INTRODUCTION

1.1 Treasury management is defined as:

"The management of the local authority's cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

1.2 The annual treasury management outturn report for 2017/18 covers:

- The economy and interest rates
- The Council's capital expenditure and financing

- Investment rates
- Borrowing strategy
- Borrowing outturn
- Compliance with Prudential and Treasury Management Indicators (Appendix A)
- Investment strategy
- Investment outturn
- Debt rescheduling
- Other issues
- List of the 10 Prudential Indicators (Appendix B)

2. The economy and interest rates in 2017/18

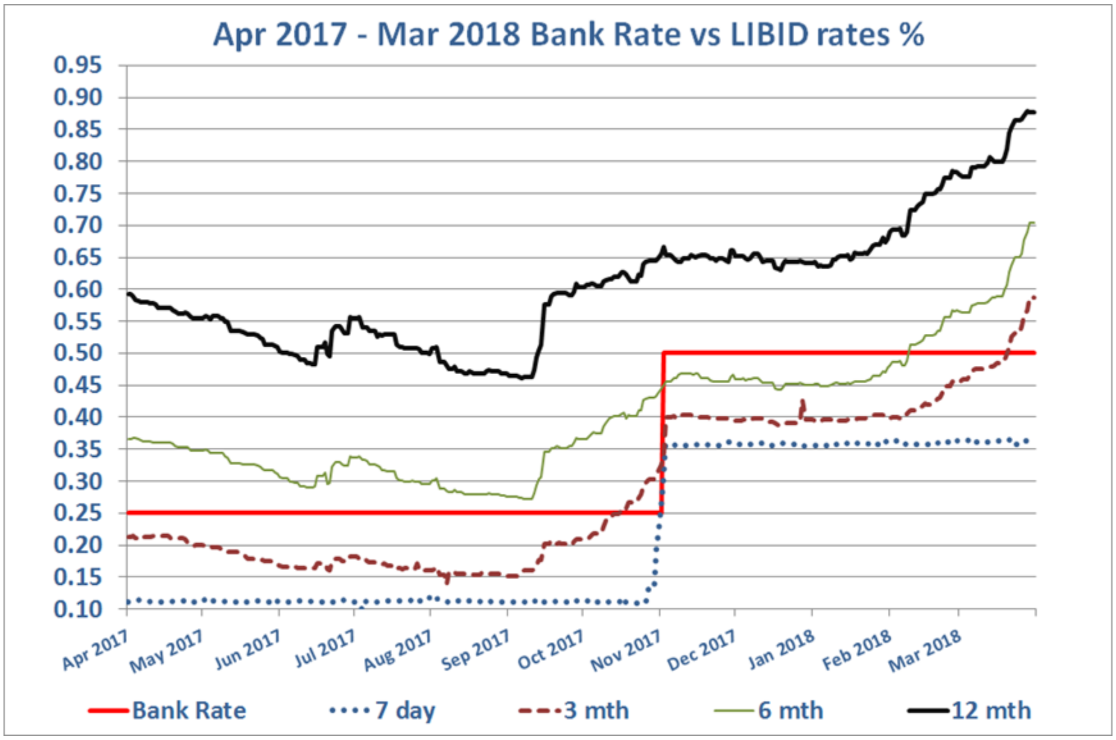
During the 2017 calendar year there was a major shift in expectations in financial markets in terms of how soon Bank Rate would start on a rising trend. After the UK economy surprised on the upside with strong growth in the second half of 2016, growth in 2017 was disappointingly weak in the first half 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 Gross Domestic Product (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 Monetary Policy Committee (MPC) would be heading in the direction of imminently raising Bank Rate. The minutes of the MPC meeting of 14th September indicated that the MPC was likely to raise Bank Rate very soon. The 2nd November MPC quarterly Inflation Report meeting duly delivered by raising Bank Rate from 0.25% to 0.50%.

The 8th 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.

Investment 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 2nd 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 28th February 2018.

2.1 **Bank Rate v London Interbank BID (LIBID) investment rates**



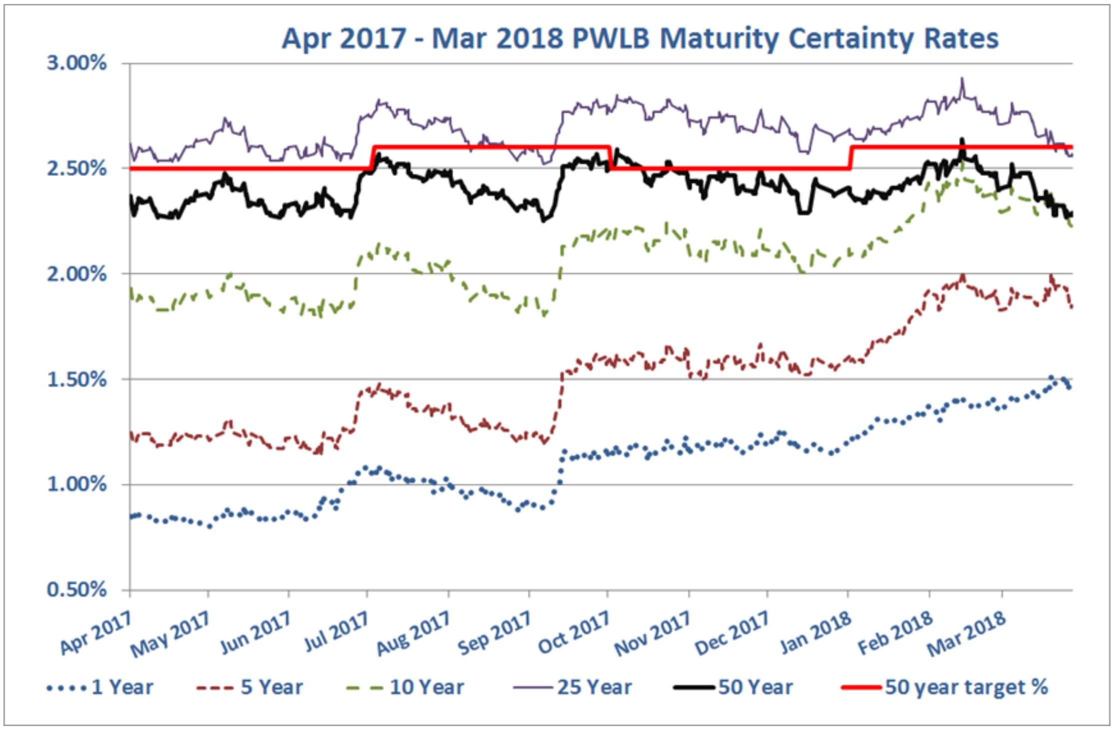
Public Works Loans Board (PWLB) borrowing rates increased correspondingly to the above developments with the shorter term rates increasing more sharply than longer term rates. In addition, UK gilts have moved in a relatively narrow band this year, within 25 basis points for much of the year, compared 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 Federal Reserve raising rates by 0.25% in June, December and March, making six increases in all from the floor. At 31/03/18 the Rate was 1.75%. 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 8th June. However, this had relatively little impact on financial markets.

2.2 **Borrowing PWLB (Certainty 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.



3. **Capital Expenditure and Financing 2017/18**

3.1 The Council finances capital expenditure resulting in an increase in long-term assets. These may either be;

- Financed immediately through the application of capital receipts, capital grants or contributions from revenue expenditure, or
- If insufficient financing is available the expenditure will give rise to a borrowing requirement

3.2 In 2017/18, major projects acquired or completed include the Asda Superstore in Wales (£11.52m), Unity House in Basingstoke (£18.66m) and 21 Mill Lane in Dorking, all of these assets were acquired by MOVA Properties, via the purchase of equity shares and loans provided by MVDC. Whilst Focal Point in Leatherhead (£8.57m) was acquired direct by MVDC. The borrowing requirement during 2017/18 was £43.439m (2016/17: £11.637m), of which £40m (2016/17: £10m) was borrowed from the Public Works Loan Board (PWLB) and the remainder was financed through internal borrowing against earmarked reserves that will need to be replenished in future years.

3.3 The table below shows how capital expenditure was financed over the past two years. Actual expenditure is lower than the estimate. This is due to three projects that did not progress, two projects where stopped by the Council as further information received rendered them outside our investment criteria. Whilst a third was withdrawn by the vendor. Members approved the carry forward to 2018/19 of £579,000 capital minor works scheme provision at the Cabinet meeting on 26th June 2018.

	2016/17 Actual £000	2017/18 Estimate £000	2017/18 Actual £000
Total capital expenditure	**17,509**	**111,120**	**48,430**
Resourced by :			
Capital receipts	2,767	1,000	2,000
Capital grants & contributions	2,293	2,237	2,768
Capital reserves	812	452	313
Borrowing	11,637	107,431	43,349
Total Resources Applied	**17,509**	**111,120**	**48,430**

4. Investment Rates in 2017/18

4.1 The market interest rates at the start and end of the year are shown below. As can be seen rates have reduced during the year from historically low levels. The reduction in interest rates, including the effect of the introduction of the Term Funding Scheme by the Government, has had a significant bearing on the interest earnings of the Authority on internal investments and will do so moving forward.

London Interbank Bid (LIBID) Rates (Average):

Notice	2015/16	2016/17	2017/18
	%	%	%
7 Day	0.360	0.211	0.206
1 Month	0.380	0.228	0.227
3 Month	0.454	0.320	0.283
6 Month	0.605	0.471	0.401
1 Year	0.897	0.712	0.609

5. Borrowing Strategy for 2017/18

5.1 The major borrowing requirement objectives to be followed in 2017/18 were;

- To forecast average future interest rates and movements in future interest rates
- To manage the Council's debt ensuring prompt payment of interest and principal on the due dates
- To secure the cheapest cost for financing capital schemes commensurate with future risk

5.2 The Council greatly values revenue budget stability and will therefore borrow the majority of its long-term funding needs at long-term fixed rates of interest. Short-term and variable rate loans will only be borrowed to the extent that they either offset short-term and variable rate investments or can be shown to produce revenue savings.

5.3 The Council commenced borrowing in 2016/17. There was a further borrowing requirement in 2017/18 to fund the capital programme. This is reflected in the higher Operational Boundary and Affordable Limits set out against Performance Indicators 6 and 7 (Appendix A).

6. **Borrowing Outturn for 2017/18**

6.1 The Council raised funds during 2017/18 through the Public Works Loans Board (PWLB).

6.2 The following loans were taken out during the year:-

Lender	Principal (£)	Type	Interest Rate (%)	Term (Maturity Loan)
PWLB	3,000,000	Fixed interest rate	2.36	50 years
PWLB	7,000,000	Fixed interest rate	2.32	50 years
PWLB	30,000,000	Fixed interest rate	2.37	50 years

7. **Compliance with Prudential and Treasury Management Indicators**

7.1 During the financial year the Council operated within the Prudential and Treasury Management Indicators 2017/18 – 2019/20 and Treasury Management Strategy and Plan 2017/18 as agreed by Council on 21st February 2017. The outturn for the Prudential and Treasury Management Indicators is detailed in Appendix A of this report.

8. **Investment Strategy for 2017/18**

8.1 The Investment Strategy's primary objectives are safeguarding the re-payment of the principal and interest of its investments on a timely basis first and ensuring adequate liquidity second, with the investment return being the third objective.

8.2 The Council's Medium Term Financial Plan, approved in 2013, set out the need to replace reducing Government Grant by income generated through making the best use of assets. The reduction in grant over the last couple of years has accelerated the need to pursue a policy of property investment to generate income in support of services.

8.3 At its meeting on 11th October 2016 the Council approved an Asset Investment Strategy (AIS) and the consequent addition of £48.5m to the capital programme for the purchase of investment assets that would deliver a good rate of return for the Council. Two private limited companies (Mova Holdings Limited and Mova Property Limited) were established to enable the Council to facilitate this Strategy. To enable the Strategy to proceed the Council needed to borrow funds as the Council's reserves were no longer sufficient to support this initiative.

8.4 On 20th February 2018 Council approved an increase in funds for investment through the Asset Investment Strategy by a further £51.5m bringing the total to £100m.

8.5 A number of property acquisitions have been successfully completed under the remit of the Asset Investment Strategy.

8.6 Investing cash balances in policy investments is a departure from previous investment strategies. This type of investment is not required to be reported in treasury management reports as they will be included in regular Asset Investment Strategy reviews. It was felt important to include reference to the AIS here to give Members a comprehensive view of how cash balances are being used and how this will impact on the treasury management function and by implication capital expenditure and treasury prudential indicators and limits moving forward.

8.7 The Council predominantly manages its investments in-house and invests with the institutions listed in the Council's approved lending list. Following the increase in planned capital spend as a consequence of the AIS, the Council now primarily invests for a range of periods less than one year dependent on the Council's cash flows, its interest rate view and the rates of interest on offer at the time.

8.8 The expectation for interest rates within the Strategy for 2017/18 anticipated the Bank Rate staying flat at 0.25%. The Bank Rate actually rose by 0.25% on 2nd November 2017 to 0.50%. Investments would continue to be dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

8.9 No institutions in which investments were made during 2017/18 had any difficulty in repaying principal and interest in full during the year.

9. Investment Outturn for 2017/18

9.1 The Council's Investment Policy is governed by the Ministry of Housing, Communities and Local Government (MHCLG) guidance, which has been implemented in the annual investment strategy approved by Council on 21st February 2017. This Policy sets out the approach for selecting 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. Counterparties are selected and limits applied using rating criteria. The application of the Council's minimum criteria will apply to the lowest available rating for any institution. For instance if an institution is rated by two agencies, one meets the Council's criteria, the other does not, the institution will fall outside the lending criteria. This is in compliance with the CIPFA Treasury Management Code of Practice. Credit rating information is supplied by our treasury management advisor (Link Asset Services, Treasury Solutions).

9.2 Detailed below is the result of the investment strategy undertaken by the Council.

Internally Managed Funds

9.3 The Council maintained its investment activities during the year, as agreed by Council on 21st February 2017.

9.4 During the year all investments were made in full compliance with the Council's treasury management policies and practices and the Council had no liquidity difficulties.

9.5 The limit to be placed, with each counterparty, remained at £7.5 million. The Council also operated a 'group limit', whereby the collective investment exposure to individual banks within the same banking group was restricted to a group total set also at £7.5 million.

9.6 The analysis below shows the activity undertaken on internally managed funds during 2017/18.

	£
Balance outstanding (at 01/04/17)	17,542,000
Investments made during the year	187,178,000
Upward revaluation of CCLA Property Fund investment (at 31/03/18)	282,000
	205,002,000
Less: Investments maturing during the year	191,296,000
Balance outstanding (at 31/03/18)	13,706,000

9.7 These investments generated interest of approximately £374,000 in the year (£379,000 in 2016/17), gross of all associated charges against a budget of £325,000. As referred to in paragraph 8.3 agreement was given to increased licence in terms of the scope and range of Council investments. During 2017/18 funds were moved from short-term investments where interest rates were performing at historically low levels. These funds were re-invested in, better performing, property purchases that generated a rental income but meant that there was less to invest in financial instruments. A proportion of investment income is received from short-term investments (investments that mature in, or are held for, 12 months or less). Also good returns are still being achieved on the investment of £5m that was made in the CCLA Property Fund on 30th June 2013 (refer to paragraph 9.10).

	Original Estimate 2017/18 £	**Actual Outturn 2017/18 £**	**Variance 2017/18 £**
Internally Managed Funds	325,000	374,093	49,093

9.8 Mole Valley achieved a rate of return of 1.61% on its internally managed funds during the year, this was based on an average fund value of approximately £23,201,000. The formal method used to compare performance is to contrast the rate of return against the average uncompounded 7-day LIBID (London Interbank BID) rate (0.2145% for 2017/18). The investment in the CCLA Property Fund, previously alluded to, has significantly enhanced the return on internally managed funds when compared to the benchmark.

9.9 Detailed below is the result of the investment strategy undertaken by the Council.

Funds	Average Fund Value	Rate of Return	Benchmark Return *
Internally / Externally Managed	£23,201,000	1.61%	0.2145%

* 7-day LIBID uncompounded 0.2145%

The uncompounded rates are for internally managed funds and exclude the roll-up of principal and interest. Upon maturity of the investment, interest is paid over with the original principal sum.

Externally Managed Funds – Churches, Charities and Local Authorities (CCLA)

9.10 On 30th June 2013 the Council invested £5m in the Churches, Charities and Local Authorities (CCLA) Property Fund. To realise the full potential of this investment it should be considered as a medium to long term placement. Income is received quarterly and in the current economic climate very good yields are still being achieved.

9.11 The Fund offers all of the advantages of a professionally managed property portfolio, with broadly diversified exposure to high quality properties in the strongest areas of the market. The Fund is a high quality, well diversified commercial and industrial property portfolio. There is a focus on delivering attractive income returns and the Fund is actively managed to add value.

9.12 CCLA has been appointed by the Local Authorities' Mutual Investment Trust (LAMIT) to manage and administer the Local Authorities' Property Fund. LAMIT was established approximately 30 years ago to provide investment services for local authorities in the UK. It is controlled by Members and Officers appointed by the Associations of Local Authorities in the United Kingdom and by Trust Members representing the Funds' unit holders.

9.13 Excellent returns of 5.36% were achieved from this Fund during the year. With the property market remaining buoyant it is anticipated that these returns will continue during 2018/19.

10. Debt rescheduling

10.1 As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

10.2 The reasons for any rescheduling to take place will include:

- the generation of cash savings and/or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

10.3 Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on the current debt.

10.4 All rescheduling will be reported to the Council, at the earliest meeting following its action.

11. **Other issues**

11.1 **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.

11.2 A particular focus of these revised codes was how to deal with local authority investments which are not treasury type eg 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.

11.3 **Markets in Financial Instruments Directive II (MiFID II)** – The European Union set the date of 3rd 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 cash deposits with banks and building societies.

12. **Financial Implications** – are covered in the body of this report.

13. **Legal Implications** - 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 (no restrictions were made in 2017/18).
- The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 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 Prudential Code required indicators to be set, some of which are limits, for a minimum of the three forthcoming years.
- 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 MHCLG (formerly DCLG) has issued Investment Guidance to structure and regulate the Council's investment activities. Updated Guidance became available on 2nd February 2018 (first published 1st April

2010). The emphasis of the Guidance for treasury management and other financial investments is that local authorities should continue to prioritise security, liquidity and yield in that order of importance.

The Council has complied with all of the above relevant statutory and regulatory requirements that 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.

14. CORPORATE IMPLICATIONS

Monitoring Officer commentary – The Monitoring Officer confirms that all relevant legal implications have been taken into account.

S151 Officer commentary - The S151 Officer confirms that all financial implications have been taken into account.

Risk Implications - The Council considers security, liquidity and yield, in that order, when making investment decisions:

Security – counterparty credit quality was assessed and monitored with reference to credit ratings, credit default swaps, gross domestic product (GDP) of the country in which the institution operates, the country's net debt as a percentage of GDP, any potential support mechanisms and share price. The minimum long-term counterparty credit rating determined for 2017/18 was A/A3/A (Fitch/Moody's/Standard and Poors).

Liquidity – the Council maintained a sufficient, though not excessive, level of liquidity during the year using a call account and short-term, fixed-rate, deposits.

Yield – the Council sought to optimise returns commensurate with its objectives of security and liquidity. Short-term money market rates remained at very low levels throughout the year which had a significant impact on investment income.

A high reliance on investment income can place the Council at significant risk of budget variation as interest rates rise and fall, which has an impact upon future Council Tax levels. The Council's Medium Term Financial Strategy addresses this risk and seeks to reduce this reliance over time.

Locking significant investments into long-term fixed-rate deals means the Council has a potential disadvantage in a rising interest market, especially if the interest rate rises above the assumption made when the long-term deal was placed.

To mitigate this, the Council's in-house team predominantly invest up to periods of three months only, hence advantage can be taken of prevailing interest rates upon the investments maturity. This minimises the disadvantage whilst maintaining certainty over the level of future return and stability in planned future Council Tax levels.

The Council will continue to look to diversify its investment portfolio and the 2017/18 Treasury Management Strategy provides for alternative investment funds should the opportunity arise.

Equalities Implications – There are no equalities implications arising as a direct consequence of this report.

Employment Issues - None within the report.

Sustainability Issues - None within the report.

Consultation – A number of meetings and telephone conversations were convened during the year involving Link Asset Services Treasury Solutions, Members and Officers.

15. **BACKGROUND PAPERS**

CIPFA Treasury Management in the Public Services – Code of Practice and Cross-Sectoral Guidance Notes (2017 edition).

CIPFA Treasury Management in the Public Services – Guidance Notes for Local Authorities including Police Authorities and Fire Authorities (2011 edition).

CIPFA the Prudential Code for Capital Finance in Local Authorities (2017 edition).

Treasury Management Annual Strategy Report 2017-18 and Prudential Indicators 2017-18 to 2019-20.

Performance management information from Link Asset Services Treasury Solutions.

2017/18 final accounts working papers.

APPENDIX A

1. **PRUDENTIAL AND TREASURY MANAGEMENT INDICATORS AND COMPLIANCE ISSUES**

1.1 The treasury management service is an important part of the overall financial management of the Council's affairs. Whilst the Prudential Indicators consider the affordability and impact of capital expenditure decisions, the treasury management service covers the effective funding of these decisions.

1.2 The 2017 edition of the Prudential Code for Capital Finance in Local Authorities requires that the actual position at year end for designated prudential indicators is reported after the year-end. The table below summarises the prudential indicator performance for 2017/18 for these indicators only.

1.3 The Council at its meeting on 21st February 2017 adopted the following prudential indicators for 2017/18 (Estimate). (The full list of Prudential Indicators is set out at Appendix B.)

PRUDENTIAL INDICATORS

2016/17 Actual	PRUDENTIAL INDICATOR	2017/18 Estimate	2017/18 Actual
	CAPITAL EXPENDITURE / AFFORDABILITY		
	Capital Expenditure Plans– Prudential Indicator 1		
£000's		**£000's**	**£000's**
17,509	Capital Expenditure	111,120	48,430
17,509	**Total**	**111,120**	**48,430**
	Capital Financing Requirement (CFR) – Prudential Indicator 2		
£000's		**£000's**	**£000's**
14,393	Capital Financing Requirement	121,515	57,619
14,393	**Total**	**121,515**	**57,619**
	Ratio of Net Financing Costs to Net Revenue Stream – Prudential Indicator 3		
%		**%**	**%**
(3.00)	Ratio of Net Financing Costs to Net Revenue Stream	1.17	(2.94)
(3.00)	**Total**	**1.17**	**(2.94)**
	Incremental Impact of Capital Investment Decisions on the Band D Council Tax – Prudential Indicator 4		
£p		**£p**	**£p**
4.44	Increase/(Decrease) in Council Tax (Band D) per annum	(11.85)	(20.64)
	Borrowing and the Capital Financing Requirement (CFR) – Prudential Indicator 5		
£000's		**£000's**	**£000's**
10,000	External Debt	119,878	50,000

Capital Financing Requirement (CFR)

1.4 The CFR is derived from the Authority's balance sheet and measures its underlying need to borrow for a capital purpose. Where capital expenditure is to be financed in future years by charges to revenue as assets are used by the Authority, the expenditure results in an increase in the Capital Financing Requirement, a measure of the capital expenditure incurred historically by the Authority that has yet to be finalised.

1.5 In accordance with best practice this Authority does not associate borrowing with particular items or types of expenditure, in day-to-day cash management no distinction can be made between capital cash and revenue cash. Any external borrowing would arise as a consequence on all financial transactions whereas this measure reflects the Authority's underlying need to borrow for a capital purpose only.

Net Borrowing and the CFR

1.6 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. 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. Prudential Indicator 6 demonstrates the Council's compliance with this.

TREASURY MANAGEMENT INDICATORS

The Operational Boundary – <u>Prudential Indicator 6</u>

1.7 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 Operational Boundary is acceptable subject to the Authorised Limit not being exceeded. The Operational Boundary does not allow for additional headroom as is the case with the Authorised Limit. A limit of £63.9m (2016/17: £30m) was used for the Operational Boundary. The actual outturn was £43.349m (2016/17: £11.7m) of which £40m (2016/17: £10m) was for external borrowing and £1.7m (2016/17: £1.7m) for finance lease liabilities.

The Authorised Limit – <u>Prudential Indicator 7</u>

1.8 The Authorised Limit is the 'Affordable Borrowing Limit' required by S3 of the Local Government Act 2003 irrespective of the Authority's indebted status. The limit is the maximum amount of external debt that can be outstanding at any one time during the financial year. The Authorised Limit also provides some headroom for unexpected cash movements. The introduction of International Financial Reporting Standards (IFRS) required finance leases to be included under other long-term liabilities on the balance sheet. A limit of £69.1m (2016/17: £35m) was used for the Authorised Limit. The actual outturn was £43.349m 2016/17: £11.7m) of which £40m (2016/17: £10m) was for external borrowing and £1.7m (2016/17: £1.7m) for finance lease liabilities.

Actual financing costs as a proportion of net revenue stream

1.9 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.

1.10 During the year the Authority borrowed £40m. Interest payable on external loans during 2017/18 was £636,000.

Investment Activity

1.11 The purpose of the following indicators is to contain the activity of the treasury management function within certain limits, thereby managing risk and reducing the impact of an adverse movement in interest rates.

1.12 **Maximum principal sums invested > 365 days – <u>Prudential Indicator 8</u>**

Maximum principal sums invested > 365 days			
	2016/17 Actual	**2017/18 Estimate**	**2017/18 Actual**
Principal sums invested > 365 days	£5.9m	£12m	£6.2m

1.13 **Interest rate exposure – <u>Prudential Indicator 9</u>**

Interest rate exposures	**2016/17 Actual**	**2017/18 Estimate**	**2017/18 Actual**
	Upper	**Upper**	**Upper**
Limits on variable interest rates:			
• Debt only	0%	20%	0%
• Investments only	30%	50%	39%
Limits on fixed interest rates:			
• Debt only	100%	100%	100%
• Investments only	70%	100%	61%

1.14 **Maturity structure of fixed interest rate borrowing 2017/18 – <u>Prudential Indicator 10</u>**

	Maturity structure of fixed interest rate borrowing 2017/18			
	2017/18 Estimate		**2017/18 Actual**	
	Lower	**Upper**	**Lower**	**Upper**
Under 12 months	0%	25%	0%	0%
12 months to 2 years	0%	25%	0%	0%
2 years to 5 years	0%	25%	0%	0%
5 years to 10 years	0%	50%	0%	0%
10 years and above	0%	100%	0%	100%

APPENDIX B

THE 10 PRUDENTIAL INDICATORS

The Indicators demonstrate overall control of capital expenditure and that the level of expenditure is sustainable and affordable. They are required by legislation to be set and approved before the start of the year, monitored during the year and reported on at year end.

They address:-

1. Plans for capital expenditure – the projected capital expenditure for each of the next three years and the source of funding.

2. Capital Financing Requirement – the anticipated need for borrowing where capital cannot be financed by existing resources.

3. Affordability indicator – the ratio of capital financing costs to the net revenue budget.

4. Affordability Indicator – the impact of capital investment decisions on Council Tax.

5. Comparison of borrowing estimate and capital financing requirement, to confirm that borrowing is intended for capital purposes only.

6. Operational Boundary for external debt – is based on the Authority's estimate of most likely - i.e. prudent, but not worst case scenario for external debt.

7. Authorised Limit for external debt – is the maximum amount of debt that the Authority can legally owe. The Authorised Limit provides headroom over and above the Operational Boundary for unusual cash movements.

8. To preserve liquidity, the maximum value of investments for more than one year.

9. To assess interest rate exposure, the upper limit on variable and fixed interest rates, in debt and investments.

10. The maturity structure of fixed interest rate borrowing, to regulate the Council's exposure to large repayment requirements.