Audit and Governance Committee

27th July 2018

Title of Report	Treasury Management Annual Report 2017/18
Purpose of Report	Each year the Council produces an Annual Report covering its Treasury Management activities for the previous year. The Annual Report is submitted each year to the Audit and Governance Committee in accordance with best practice as outlined in CIPFA's Code of Practice on Treasury Management.
Recommendations	To consider the Treasury Management Annual Report 2017/18.
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Treasury Management Annual Report 2017/18

REPORT CONTENTS

1. Background

Gloucestershire County Council's (the Council's) treasury management activity is underpinned by CIPFA's Code of Practice on Treasury Management (the Code), which requires local authorities to produce annually Prudential Indicators and a Treasury Management Strategy Statement (TMSS) on the likely financing and investment activity. The Code also recommends that members are informed of treasury management activities at least twice a year. To comply with this requirement the TMSS and Annual Investment Strategy (AIS) is agreed annually by full Council as part of the budget setting process. Scrutiny of these documents as well as a Mid Year Report and the Annual Report is delegated to the Audit and Governance Committee.

The Council has invested substantial sums of money during the year 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.

This report covers treasury activity and the associated monitoring and control of risk. A glossary is provided at Appendix A due to the technical terms and acronyms associated with treasury activity.

2. Economic Background

Treasury Management activities at the Council are driven by the prevailing economic conditions. A summary of these conditions over the financial year, provided by our Treasury Management advisors, is attached at Appendix B. In summary the financial year has been characterised by low interest rates and uncertainty in the markets, with one base rate rise, the first in ten years, to 0.5% in November 2017. Slowing growth has been a feature with inflation rising in year falling but back to 2.5% by the end of March 2018. This has meant that rates on offer in the traditional treasury instruments have been poor, although the base rate rise has meant an improvement in shorter dated instrument rates. Value in longer dated traditional instruments has been poor leading to a shorter dated strategy in year.

3. 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 incorporated into the TMSS.

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. This strategy was produced and approved by full Council, in February 2018, as part of the MTFS process, together with the TMSS and AIS.

The 2017 Treasury Management Code updates the definition of ‘investments’ widening it 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 now be discussed in the Capital Strategy or AIS and the additional risks of such investments need to be set out clearly with the impact on financial sustainability identified and reported. Amendments were made to include the non treasury investments as part of the TMSS and AIS approved in February 2018.

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 now 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 included having an investment balance of at least £10 million and the person(s) authorised to make investment decisions on behalf of the authority 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.

4. Borrowing and Debt Management

The Council has a fully funded capital programme and there was no new long term borrowing requirement for 2017/18, with all new schemes being funded in full from grants, revenue contributions, capital receipts or contributions.

The Council’s strategy is to reduce debt, and in 2017/18 the Council reduced its Capital Financing Requirement (CFR) – the total borrowing required to fund the approved capital programme - from £308.8m to £302.0m. The average cost of borrowing during

2017/18 was 5.07% - the same as 2016/17. This rate is significantly higher than the rate of return achieved on investments but reflects the mix of long term fixed rate loans taken out historically to reduce the risk associated with short term interest rate volatility.

The opening and closing external borrowing portfolio (including the on balance sheet PFI liabilities) is summarised below:

	Balance on 31/3/2017	Debt Maturing	Debt Prematurely Repaid	New Borrowing	Balance on 31/3/2018	Avg Rate
	£m	£m	£m	£m	£m	%
Fixed rate loans – PWLB	252.799	8.336	0.000	0.000	244.463	5.19
Variable rate loans – PWLB	0.000	0.000	0.000	0.000	0.000	0.00
Fixed rate loans – LOBO	33.050	0.000	0.000	0.000	33.050	4.23
Fixed rate loans – Market	8.000	0.000	0.000	0.000	8.000	5.00
TOTAL BORROWING	**293.849**	**8.336**	**0.000**	**0.000**	**285.513**	**5.07**
Other Long Term Liabilities	20.392	0.566	0.000	0.000	19.826	
TOTAL EXTERNAL DEBT	**314.241**	**8.902**	**0.000**	**0.000**	**305.339**	
Internal Borrowing	-5.399	-2.136			-3.263	
Total Borrowing Requirement	**308.842**				**302.076**	
Increase/ (Decrease) in Borrowing £m		**(6.766)**		0.000		

Notes to Table

- **Market Loans (LOBOs) and Fixed Market Loans:** The Council holds £33.05m of LOBO loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. All of these LOBOs had options during the year, none of which were exercised by the lender. Previously a further £8 million of loans with Barclays were classified as LOBOs; however Barclays have since fixed the interest rates on these loans until maturity. These are classified as fixed rate market loans.
- **Public Works Loans Board (PWLB)**: 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**: These liabilities are associated with the Council's PFI schemes. Under current accounting regulations the Council must show PFI liabilities as part of the total debt of the Council. The schemes include a Fire Joint Training Centre, four new Fire Stations and a Community Life Skills Centre.

The table below reconciles the opening and closing total borrowing position during 2017/18:

	£m
Opening CFR	**308.842**
New Borrowing	0
MRP	6.766
Total	**302.076**
Closing CFR	**302.076**
External Debt	285.513
PFI Debt	19.826
Internal Debt	-3.263
Total Debt	**302.076**

The minimum revenue provision (MRP) shown above of £6.77m is a statutory minimum amount by which the Council must reduce debt. Note that a negative internally funded position is shown. This has occurred due to the historic profile of debt where past statutory provision has paid off more debt than the Council had maturing. Future debt repayments will bring this figure back into balance.

A graph of the maturity profile of our external loans during 2017/18 is shown in Appendix C. Generally the maturity profile is well spread.

5. Investment Activity

The Council has held significant invested funds, representing income received in advance of expenditure plus balances and reserves. During 2017/18 the Council's investment balances have varied – the average was £331.1 million. This generated interest of £3.9m which is equivalent to 1.18%. This return was achieved during a period when the bank rate was 0.25% for the majority of the year.

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.

The table below summarises investment activity during the year;

Total number of loans made to 31 March 2018	153
Daily range	£0.04m to £15.0m
Total value of loans made to 31 March 2018	£723m
Maximum value per term loan made (non call)	£15.0m
Maximum value of loans made (Call)	£14.8m
Periods	Overnight to 2 years

All investments made during the year complied with the Council's agreed Treasury Management Strategy, Prudential Indicators, Treasury Management Practices and prescribed limits as approved by the County Council in February 2017. All maturing investments were repaid to the Council in full and in a timely manner.

The opening and closing investment balances are summarised in the table below;

Investments	Balance on 31/03/2017 £m	Investments Made £m	Maturities/ Investments Sold £m	Balance on 31/03/2018 £m	Avg Rate (%)
Short term Investments (call accounts, deposits)					
- Banks and Building Societies with ratings of A- or higher	70.0	20.0	-49.0	41.0	0.7
- UK Government	0.0	0.0	0.0	0.0	0
- Local Authorities	23.0	20.0	-2.9	40.1	0.9
- Housing Association	0.0	5.0	0.0	5.0	1.3
- Covered Bonds/ FRN (secured)	11.9	32.4	-13.1	31.2	0.8
Long term Investments					
- Banks and Building Societies with ratings of A- or higher	2.2	0.0	-1.2	1.0	1.9
- CCLA Property Fund	20.0	5.0	0.0	25.0	4.3
- Housing Association	0.0	5.0	0.0	5.0	2.0
- Covered Bonds/ FRN (secured)	38.8	0.0	-32.4	6.4	1.0
- Local Authorities	71.0	0.0	-12.0	59.0	1.7
Money Market Funds	19.8	454.1	-457.0	16.9	0.5
Other Pooled Funds	50.0	5.0	0.0	55.0	0.7
Other organisations (e.g. loans to small businesses)	0.1	0.0	0.0	0.1	4.9
TOTAL INVESTMENTS	**306.8**			**285.7**	
Increase/ (Decrease) in Investments £m				-21.1	

Notes to Table

- **Local Authority Mortgage Scheme (LAMs):** The long term investment with banks shown above of £1.0m is the Councils investment in the LAMs scheme. This was set up to assist local property buyers, with the Council offering a top-up indemnity to the value of the difference between the typical LTV (i.e. 75%) and a 95% LTV mortgage. The potential buyer will thereby obtain a 95% mortgage on similar terms as a 75% mortgage, but without the need to provide the substantial deposit usually required. The scheme will run for 5 years, with the interest rate being fixed for that period.
- **Funding Circle:** The £0.1m invested with other organisations relates to the Council's investment in Funding Circle as part of the commitment to economic development. This scheme was originally intended to assist small businesses in Gloucestershire, with the Council providing £2,500 per Gloucestershire business on the platform. 69 Gloucestershire businesses were assisted, however in December 2016 the platform changed and we were unable to target Gloucestershire businesses. The money in the platform is continually recycled, and is now assisting businesses country wide.

Investment Objectives

1) Security

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. The Council has continued to reduce its exposure to unsecured investments in banks and building societies and increase exposure to more secure investments, such as other local authorities. Although no additional covered instruments have been taken out during the year, we continue to hold 13% of the portfolio in both covered floating rate notes and covered bonds. These instruments have durations ranging from 1 month to 3 years. These "covered" investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that the deposit is exempt from bail-in.

The Council receives regular correspondence from its Treasury Advisors on credit risk, and this is taken into account before transactions are made. The Council used long term credit criteria during 2017/18, with minimum long-term counterparty credit rating determined for the 2017/18 treasury strategy being A-/A-/A3 across rating agencies Fitch, S&P and Moody's.

Council's counterparty credit quality has been maintained as demonstrated by the Credit Score Analysis summarised below. The table in Appendix D explains the credit score, and it is clear that our score improves over the year and is much lower than other county authorities within the benchmarking group.

	Credit Score	Credit Rating	Bail-in Exposure	WAM* (days)	Rate of Return
31.03.2017	3.15	AA	28%	423	0.96%
30.06.2017	3.47	AA	41%	356	0.89%
30.09.2017	3.31	AA	27%	323	0.89%
31.12.2017	3.52	AA	25%	343	0.92%
31.03.2018	**3.36**	**AA**	**21%**	**272**	**1.05%**
Similar LAs	**4.03**	**AA-**	**55%**	**879**	**0.94%**

**Refers to weighted average maturity*

The Rate of Return shown in the table above is a quarterly position, so not directly comparable to the annual rate of return, achieved by the Council over the year.

Risk is further reduced by ensuring a good mix of duration of deposits and mix of counterparties. The table below shows a comparison between years.

Average Length of investments		
	At 31/3/17 %	**At 31/3/18 %**
Less than 1 month (including Call)	22.9	25.3
Between 1 to 3 months	19.0	32.4
Between 3 to 6 months	1.7	5.3
Between 6 to 12 months	13.8	5.3
Over 12 months	42.6	31.7
Total	100.0	100.0

Investments by type of institution		
	At 31/3/17 %	**At 31/3/18 %**
Building Societies	1.6	0.4
UK Banks	8.2	1.8
Other Local Authorities	30.9	35.4
Covered Instruments	16.7	13.4

Call Accounts	0.0	0.3
Money Market Funds (MMF's)	22.9	25.5
Non UK Banks	8.2	0.0
Notice Accounts	4.9	10.7
Property Fund	6.6	9.0
Housing Association	0.0	3.5
Total	100.0	100.0

2) ***Liquidity***: In keeping with the DCLG's Guidance on Investments, the Council maintained a sufficient level of liquidity through the use of Money Market Funds, overnight deposits and call accounts.

3) ***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 which had a significant impact on investment income. Income earned on longer-dated deposits provided some cushion against the low interest rate environment.

6. 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.

In 2012 the Council approved £2.2 million of funding over two years, to participate in a "cash-backed" indemnity Local Government Mortgage Scheme with Lloyds Bank. This was part of a package of Economic Development measures designed to assist the local community. The scheme was funded through a specific capital scheme and the income generated was treated as a capital receipt in accordance with accounting requirements. One scheme has now come to an end with £1.2 million being returned during 2017/18, and the second scheme matured in May 2018, with £1 million maturing. Maturing money is now within the capital receipts balance on the Council's balance sheet.

The Council currently holds £0.117m of investments in Funding Circle for the purpose of supporting businesses within Gloucestershire, which was part of the package of Economic Development measures designed to assist the local community. Following a change in how the platform is run, this money is now invested across the UK, and no longer targeted at businesses purely in Gloucestershire. Money earnt is reinvested in the fund, and currently the balance including interest is £0.117m, an increase from £0.110m in 2016/17.

7. Compliance Report

All treasury management activities undertaken during 2017/18 complied fully with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy set in February 2017 (which can be accessed through the following link: https://www.gloucestershire.gov.uk/council-and-democracy/performance-and-spending/budget-and-medium-term-financial-strategy/). Details can be found in Appendix E.

In compliance with the requirements of the CIPFA Code of Practice this report provides members with a summary report of the treasury management activity during 2017/18. None of the Prudential Indicators have been breached and a prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.

8. Investment Training

Training was undertaken for members in January 2018. This was provided by our Treasury Management advisors, Arlingclose. Officers ensure that they are kept up to date on treasury related matters and training and attendance at updates with the Council's advisors is undertaken as appropriate.

Appendix A

GLOSSARY OF TERMS

Basis Point
A measure of percentage where 1 basis point is equivalent to 0.01%.

Call Account
A bank account with instant access to funds held on deposit.

Capital Financing Requirement
The total borrowing required by the Council to support the Capital programme.

Certainty Rate
A borrowing rate offered by the PWLB at 20 basis points below normally available rates.

Certificate of Deposit (CD)
A savings certificate entitling the bearer to receive interest. A CD bears a maturity date, a specified fixed interest rate and can be issued in any denomination, although the Council only trades in sterling. A CD can be sold before maturity.

CIPFA – **Chartered Institute of Public Finance and Accountancy**
Leading professional accountancy bodies in the UK and the only one which specialises in the public services.

Credit Default Swap (CDS)
A credit default swap (CDS) is a financial swap agreement that the seller of the CDS will compensate the buyer in the event of a loan default or other credit event.

Custody Account
A facility to enable the Council to access alternative investments instruments that require specialist electronic settlement systems.

Debt Management Office (DMO)
An Executive Agency of Her Majesty's Treasury. The DMO's responsibilities include debt and cash management for the UK Government, lending to local authorities and managing certain public sector funds.

Discount
A deductable sum - calculated on normal actuarial principles – which a lender pays to the Council if a loan is repaid early and if interest rates are presently higher than the loan rate. The discount reflects the gain to the lender of foregoing the remaining instalments of interest, and receiving funds which have to be re-invested at current interest rates.

Funding for Lending Scheme
The Bank and HM Treasury launched the Funding for Lending Scheme (FLS) on 13 July 2012. The FLS is designed to incentivise banks and building societies to boost their lending to the UK real economy. It does this by providing funding to banks and building societies for an extended period, with both the price and quantity of funding provided linked to their lending performance.

GDP
Gross Domestic Product.

Gilt
Long term fixed income debt security (bond) issued by the UK Government and traded on the London Stock Exchange

LAMIT
Local Authority Mutual Investment Trust.

LOBO (Lender's Option / Borrowers Option)
Money Market instruments that have a fixed initial term (typically one to ten years) and then move to an arrangement whereby the lender can decide at pre-determined intervals to adjust the rate on the loan. At this stage the borrower has the option to repay the loan.

London Inter-Bank Bid Rate (LIBID)
The interest rate at which major banks in London are willing to borrow (bid for) funds from each other.

Minimum Revenue Provision
The minimum amount which must be charged to an authority's revenue account each year and set aside towards repaying borrowing

Money Market
The term applied to the institutions willing to trade in financial instruments. It is not a physical creation, but an electronic/telephonic one.

PFI Liabilities
A requirement under current accounting standards to include all Private Financing arrangements within the borrowing requirement, to reflect the additional liability on the Council from these schemes.

Pooled Fund
Investments are made with an organisation that pool together investments from other organisations and apply the same investment strategy to the portfolio. Pooled fund investments benefit from economies of scale, which allows for lower trading costs per pound, diversification and professional money management.

Premium
An additional sum - calculated on normal actuarial principles – which the authority pays to a lender if a loan is repaid early and if interest rates are presently lower than the loan rate. The premium reflects the loss to the lender of foregoing the remaining instalments of interest, and receiving funds which have to be re-invested at current interest rates.

Prudential Indicator
Indicators set out in the Prudential Code that calculates the financial impact and sets limits for treasury management activities and capital investment.

PWLB – Public Works Loan Board
An independent statutory body operated within the **Debt Management Office**, which is able to meet all of a local authority's needs for long-term borrowing. The PWLB is prepared to lend to authorities who act prudently and comply with all relevant legislation.

RISK:
Credit and counterparty risk
The risk of failure by a counterparty to meet its contractual obligations to the organisation under an investment, borrowing, capital, project or partnership financing, particularly as a result of the counterparty's diminished creditworthiness, and the resulting detrimental effect on the organisation's capital or current (revenue) resources.

Liquidity risk
The risk that cash will not be available when it is needed, that ineffective management of liquidity creates additional unbudgeted costs, and that the organisation's

Interest Rate risk
The risk that cash will not be available when it is needed, that ineffective management of liquidity creates additional unbudgeted costs, and that the organisation's business/service objectives will be thereby compromised.

Refinancing risk
The risk that maturing borrowings, capital, project or partnership financings cannot be refinanced on terms that reflect the provisions made by the organisation for those refinancings, both capital and current (revenue), and/or that the terms are inconsistent with prevailing market conditions at the time.

Legal Risk
The risk that the organisation itself, or an organisation with which it is dealing in its treasury management activities, fails to act in accordance with its legal powers or regulatory requirements, and that the organisation suffers losses accordingly.

Operational Risk
The risk that an organisation fails to identify the circumstances in which it may be exposed to the risk of loss through fraud, error, corruption or other eventualities in its treasury management dealings, and fails to employ suitable systems and procedures and maintain effective contingency management arrangements to these ends. It includes the area of risk commonly referred to as operational risk.

Market Risk
The risk that, through adverse market fluctuations in the value of the principal sums an organisation borrows and invests, its stated treasury management policies and objectives are compromised, against which effects it has failed to protect itself adequately.

Stable Net Asset Value Money Market Funds
The principle invested remains at its invested value and achieves a return on investment.

Voluntary Revenue Provision
Any amount set aside to reduce the Capital financing Requirement over and above the MRP.

Economic Update

The bullets below provided by our treasury advisors are a summary of the economic climate over the financial year 2017/18 that has impacted on the treasury management environment of the Council:

- **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.

- **Growth and Inflation**: The UK economy showed signs of slowing with latest estimates showing GDP, helped by an improving global economy, grew by 1.8% in calendar 2017, the same level as in 2016. This was a far better outcome than the majority of forecasts following the EU Referendum in June 2016, but it also reflected 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.

- **Interest Rates;** 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.

- **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.

- **Gilts:** 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.

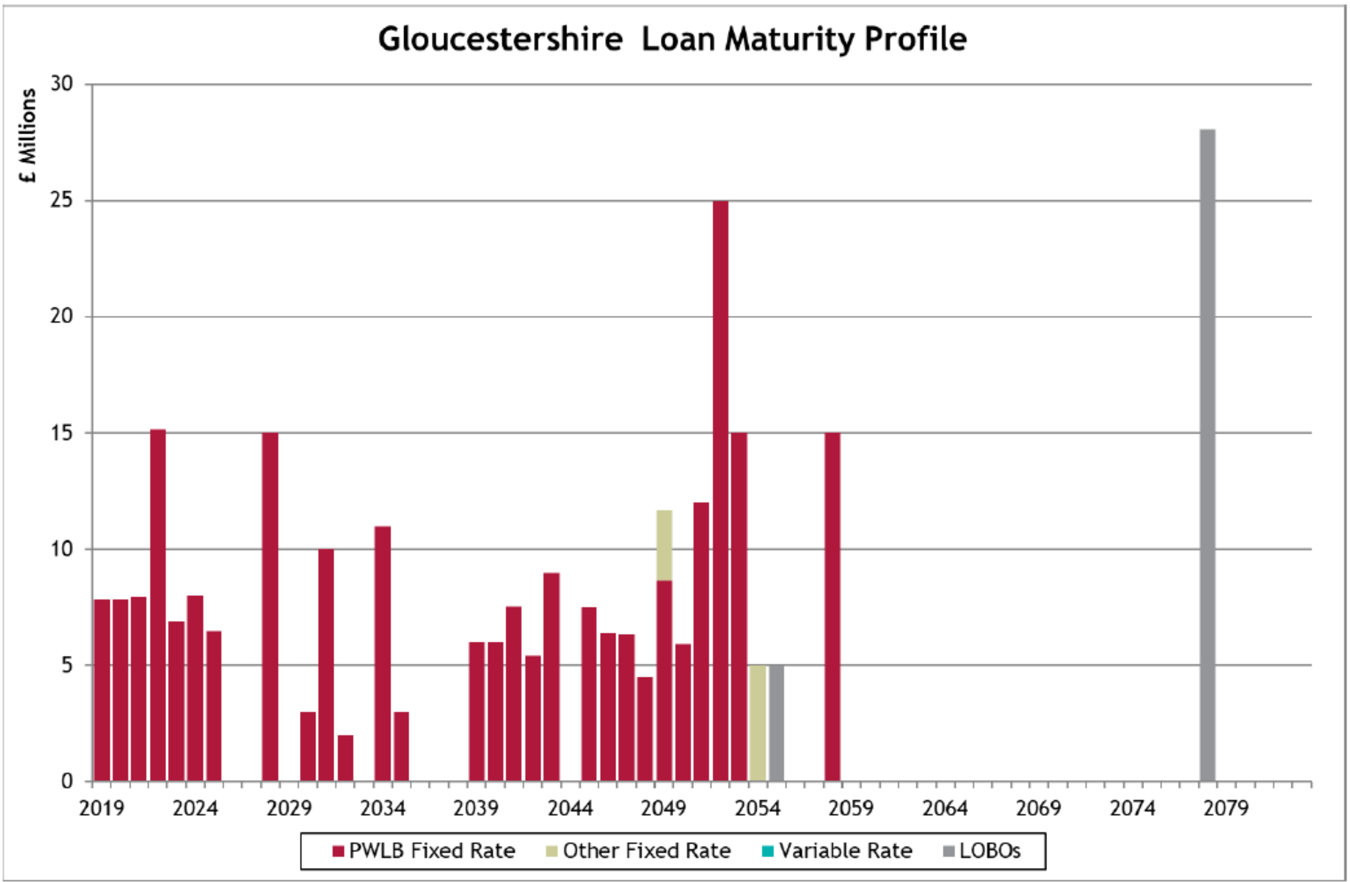
  Changes to credit ratings included Moody's downgrade of Standard Chartered Bank's long-term rating to A1 from Aa3 and the placing of UK banks' long-term ratings on review, to reflect the impending ring-fencing of retail activity from investment banking (Barclays, HSBC and RBS were on review for downgrade;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

Appendix C

Loan Profile



Although the spread of borrowing is generally smooth there are a number of peaks. The peak in 2051/52 is because there are three loans maturing, one of which is for £15m. The peak in 2077/78 is the final date of maturity for a number of LOBOs loans. Note that LOBO loans are shown at maturity rather than the earliest call (option) date.

<u>Appendix D</u>

Credit Score Analysis

<u>Scoring:</u>

Long-Term Credit Rating	Score
AAA	1
AA+	2
AA	3
AA-	4
A+	5
A	6
A-	7
BBB+	8
BBB	9
BBB-	10

The value weighted average reflects the credit quality of investments according to the size of the deposit. The time weighted average reflects the credit quality of investments according to the maturity of the deposit

The Council aimed to achieve a score of 7 or lower, to reflect the Council's overriding priority of security of monies invested and the minimum credit rating of threshold of A- for investment counterparties.

Appendix E

Compliance Statement: Prudential Indicators

Capital Financing Requirement

The Capital Financing Requirement is the total amount required by the Council to fully fund the Capital Programme. In effect it is therefore the total borrowing requirement of the Council. The outturn position for the Council's cumulative maximum external borrowing requirement for 2017/18 is shown in the table below:

	31/03/2018 Actual £m
CFR	302.076
Less: Existing Profile of Borrowing	285.513
Less: Other Long Term Liabilities*	19.826
Cumulative Maximum External Borrowing Requirement	**(3.263)**
Useable Reserves **	(241.434)
Cumulative Net Borrowing Requirement/(investments)	**(244.697)**

**Other long term liabilities are the Council's PFI schemes. This includes a Fire Joint Training Centre, and 4 new Fire Stations and a Community Life Skills Centre. Under current accounting regulations the Council must show these liabilities as part of the total debt of the Council.*

***Reserves shown here may differ slightly to those shown in the Statement of Accounts following approval by Cabinet for carry forwards, which may increase the final reserves amount.*

Prudential Indicator Compliance

(a) Authorised Limit and Operational Boundary for External Debt

The Local Government Act 2003 requires the Council to set an affordable Authorised Borrowing Limit, irrespective of their indebted status. This is a statutory limit which should not be breached. The Council's Authorised Borrowing Limit was £363m for 2017/18. This limit represents a worse case scenario for debt required and is calculated as the total capital financing requirement, plus the minimum revenue provision, plus maturing debt, and capital receipts. Added to this is an allowance to cover the possibility of not being able to make monthly salary payments. This allows the Council flexibility with its total borrowing requirement.

The Operational Boundary is based on the same estimates as the Authorised Limit but reflects the most likely, prudent but not worst case scenario without the additional headroom included within the Authorised Limit. The Operational Boundary for 2017/18 was £343m.

There were no breaches to the Authorised Limit and the Operational Boundary during the year; borrowing at its peak was £315m.

(b) Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure

- These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates.
- The upper limit for variable rate exposure allows for the use of variable rate debt to offset exposure to changes in short-term rates on our portfolio of investments.

	2017/18 Actual £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
Upper limit for Fixed Interest Rate exposure	320.000	320.000	340.000	350.000
Upper limit for Variable Interest Rate exposure	0	0	0	0

(c) Maturity Structure of Fixed Rate Borrowing

- This indicator is to limit large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates.

Maturity Structure of Fixed Rate Borrowing	Upper Limit	Lower Limit	Actual Fixed Rate £m Borrowing as at 31/03/18	Actual Fixed Rate £m Borrowing as at 31/03/18	Actual Fixed Rate £m Borrowing as at 31/03/18	Fixed Rate Borrowing as at 31/03/18	Compliance with Set Limits?
	%	%	LOBO*	Market	PWLB	%	
under 12 months	25	0	33.050		7.863	14.3	Yes
12 months and within 24 months	25	0			7.863	2.8	Yes
24 months and within 5 years	50	0			44.509	15.6	Yes
5 years and within 10 years	75	0			15.000	5.3	Yes
10 years and within 20 years	100	0			29.000	10.2	Yes
20 years and within 30 years	100	0			54.171	19.0	Yes
30 years and within 40 years	100	0		8.000	71.057	27.7	Yes
40 years and within 50 years	100	0			15.000	5.3	Yes

* Note that LOBO's are included in the table above at earliest call date and not at maturity.

(d) Actual External Debt

This indicator is obtained directly from the Council's balance sheet. It is the closing balance for actual gross borrowing (short and long-term) plus other deferred liabilities. The indicator is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit.

Debt	31.03.18 Actual £m
Borrowing	285.513
PFI liabilities	19.825
Total Debt	**305.338**

(e) **Total principal sums invested for periods longer than 364 days**

- This indicator allows the Council to manage the risk inherent in investments longer than 364 days.
- The limit for 2017/18 was set at £200m. At its peak sums invested for longer than 365 totalled £117.6m.

(f) **Capital Expenditure**

This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits, and, in particular, to consider the impact on Council tax.

	2017/18 Actual £m	2016/17 Actual £m
Capital Expenditure	**95.875**	**84.649**

Capital expenditure has been financed as follows:

Capital Financing	2017/18 Actual £m
GCC Revenue contributions	3.129
Capital Receipts	12.940
Capital Fund	8.831
Reserves	1.803
Grants	58.754
External contributions	10.418
Total Financing	**95.875**
Borrowing	0.000
Total Funding	**0.000**
Total Financing and Funding	**95.875**

The table shows that the capital expenditure plans of the Council could be funded entirely from sources other than external borrowing.

(g) **Ratio of Financing Costs to Net Revenue Stream**

- This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs.
- The ratio is based on costs net of investment income.

	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Ratio of Financing Costs to Net Revenue Stream	4.86%	4.76%	4.58%	4.52%

(h) **Incremental Impact of Capital Investment Decisions**

- This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax. The incremental impact is calculated by comparing the total revenue budget requirement of the current approved capital programme with an equivalent calculation of the revenue budget requirement arising from the proposed capital programme.

Incremental Impact of Capital Investment Decisions	2017/18 Actual £	2018/19 Estimate £	2019/20 Estimate £	2020/21 Estimate £
Increase in Band D Council Tax	0.00	1.61	5.72	7.40