

FAREHAM

BOROUGH COUNCIL

Report to the Executive for Decision 09 July 2018

Portfolio:	Policy and Resources
Subject:	Capital and Treasury Management Outturn 2017/18
Report of:	Director of Finance and Resources
Corporate Priorities:	A dynamic, prudent and progressive Council

Purpose:

This report provides the Executive with details of the capital and treasury management outturn for 2017/18 to comply with the reporting requirements of the Code of Practice for Treasury Management. The report also seeks approval for the proposed methods of financing the General Fund capital programme.

Executive summary:

Actual capital expenditure on General Fund schemes in 2017/18 was £23,295,118 compared with the revised capital programme of £24,405,900. The overall variance was £1,110,782 and a detailed analysis of the variations is given in Appendix A to this report.

Total savings of £79,516 were achieved, additional expenditure of £133,275 was incurred and a total of £1,164,541 will be carried forward into 2018/19. Details of the various methods used to finance this expenditure are set out in this report.

Full details of Treasury Management investment and borrowing activity in 2017/18 are also set out in this report. Treasury activity in 2017/18 is summarised below:

	31 March 2017 Actual £'000	2017/18 Movement £'000	31 March 2018 Actual £'000
Total borrowing	41,835	10,182	52,017
Total investments	(15,000)	3,000	(12,000)
Net borrowing	26,835	13,182	40,017

Net interest received in 2017/18 was £417,911 and net interest paid was £1,742,168.

During 2017/18, the Council complied with its legislative and regulatory requirements of the Prudential Code.

Recommendation:

It is recommended that the Executive:

- (a) approves that the General Fund capital programme for 2017/18 be approved and financed as set out in this report;
- (b) agrees that the additional expenditure incurred, amounting to £133,275 be financed retrospectively from surplus capital resources; and
- (c) notes the treasury management activity for 2017/18.

Reason:

To provide the Executive with details of the capital and treasury management outturn in 2017/18 and to comply with the reporting requirements of the Code of Practice for Treasury Management.

Cost of proposals:

The necessary resources are available to finance the General Fund capital programme for 2017/18 including the additional expenditure of £133,275.

Appendices:

- A:** Capital Expenditure and Financing 2017/18
- B:** Economic Commentary by Treasury Advisors, Arlingclose
- C:** Prudential and Treasury Indicators 2017/18

Background papers: None

Reference papers: Treasury Management Strategy and Prudential Indicators 2017/18, Council, 27 February 2017

Westbury Manor Museum Re-Modelling Proposal, Executive, 6 June 2016

CIPFA Code of Practice for Treasury Management

FAREHAM

BOROUGH COUNCIL

Executive Briefing Paper

Date:	09 July 2018
Subject:	Capital and Treasury Management Outturn 2017/18
Briefing by:	Director of Finance and Resources
Portfolio:	Policy and Resources

INTRODUCTION

1. This report provides the Executive with details of the capital and treasury management outturn for 2017/18 to comply with the reporting requirements of the Code of Practice for Treasury Management.

CAPITAL OUTTURN REPORT 2017/18

2. The capital programme for 2017/18, approved in February this year for the General Fund was £24,405,900. The actual capital expenditure, detailed in Appendix A, was £23,295,118 giving an overall variation of £1,110,782. A summary, including savings and additional expenditure, is summarised in the table below.

	Revised Budget £	Actual £	Savings £	Additional Expenditure £	Carry forward £
Streetscene	129,700	76,097	0	7,826	61,429
Planning & Development	938,000	906,342	25,917	5,816	11,557
Leisure & Community	1,115,200	1,019,386	25,010	33,169	103,973
Housing	903,700	644,748	0	49,221	308,173
Policy & Resources	21,319,300	20,648,545	28,589	37,243	679,409
Total	24,405,900	23,295,118	79,516	133,275	1,164,541

SAVINGS AND ADDITIONAL EXPENDITURE

3. Savings of £79,516 were recognised as follows:
 - £28,589 for Daedalus Development relating to the new hangars schemes.
 - £25,917 for River Wallington Gabion Replacement Works. This scheme had a large contingency due to the higher risks associated with working in water which was not needed.

- £25,010 for Play and Parks Schemes. Newtown, Sarisbury Green and Howerts Close Play Areas all came in under budget. Howerts Close was under budget as the play area was dismantled and closed rather than refurbished. Following a consultation it was agreed that the neighbouring Warsash Play Area would be refurbished and enlarged in 2018/19 instead.

4. Additional expenditure of £133,275 was needed mainly for the following schemes:

- £49,221 for Housing Feasibility Studies relating to design and architects' costs, topographical and utility surveys, arboricultural advice and ecological studies at proposed housing development sites.
- £35,494 for the Acquisition of Welborne Properties due to an increase in the market value of properties in Fareham since the budget for the scheme was set.

5. In addition, £150,606 of expenditure was incurred ahead of budget and will be carried forward to reduce next year's capital budget.

CARRY FORWARDS TO 2018/19

6. There are a number of schemes still in progress and a total budget of £1,164,541 will be carried forward to 2018/19.

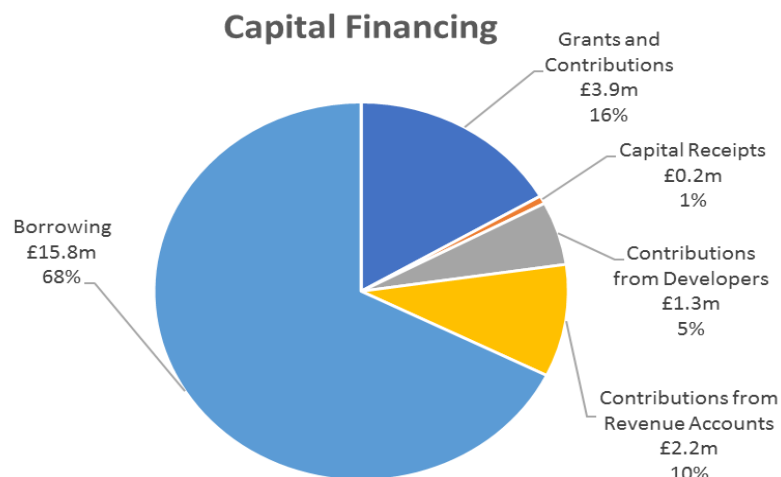
7. The largest carry forward is for the Daedalus Development of £638,203, this includes retention payments for the new general aviation and business hangars and ongoing works at Daedalus West and the Control Tower.

CAPITAL PROGRAMME 2018/19 TO 2022/23

8. The General Fund capital programme will be reviewed by officers in light of the slippage and re-phasing of works and an updated programme for 2018/19 to 2022/23 will be presented to the Executive as part of the Finance Strategy for 2019/20.

CAPITAL FINANCING

9. The various methods used to finance the capital expenditure in 2017/18 are set out in the chart below.



SIGNIFICANT SCHEMES

10. The Council has continued to invest in Daedalus as it seeks to fulfil its commitment to preserve the future of the airfield. The Council's Vision is for Daedalus to become the premier location for marine, aviation, aerospace engineering and advanced manufacturing businesses in the south; contributing to 3,500 new local jobs over the next ten years.
11. During 2017/18 significant progress has been made:
 - Capital investment of £7 million, £2 million of which was provided by the Solent Local Enterprise Partnership, has funded the expansion of Fareham Innovation Centre, doubling its capacity. The Centre now benefits from 33 new offices, 5 new workshops and state-of-the-art conference facilities.
 - Refurbishment of two industrial buildings and 11 hangars were completed at a cost of £10 million.
 - Refurbishment of the air traffic control tower, the airport lounge, Café at Zero5 and a new outdoor viewing area were completed.
 - The lease for land was granted to the National Grid's IFA2 development to proceed to construction stage. The Borough will benefit from future land value income and the community benefits including the creation of Daedalus Common.
 - Provision of a fuel farm costing £400,000.
12. Completion of Hill Head Coastal Protection project. Funded through £740,000 of Community Infrastructure Levy contributions, the works undertaken at Hill Head will protect the coastline from the effects of extreme weather and sea level rise.
13. Capital Funding of Westbury Manor Museum of £385,000 in partnership with the Hampshire Cultural Trust to improve the business plan for the museum in terms of being self-sustaining and reducing the Council's annual revenue contribution. The Museum reopened in summer 2017 as a vibrant new 'culture stop' and now features artist's studios together with a mix of interactive exhibits and digital media. The reception area and café experience has been transformed and now includes a shop selling local Hampshire produce.
14. Holly Hill Play Area opened in 2017. Located next to Holly Hill Leisure Centre in Sarisbury, the park features a wide range of exciting facilities for children, young people and families to enjoy. The children's play area offers a variety of play equipment, suitable for all ages and abilities. It includes a zip wire, inclusive swing, huge climbing units and much more. For older children, there is a multi-use games area (MUGA), which is a hard-standing surface that can be used all year round to play outdoor sports. Items of outdoor gym equipment are also included within the site as well as a selection of seats, picnic tables and footpaths.
15. The Council is investing in five fuel-efficient refuse trucks compliant with the Euro VI emissions regulations as part of the move to a cleaner greener vehicle fleet. These are being purchased over 2 years at a cost of £813,000.

TREASURY MANAGEMENT OUTTURN REPORT 2017/18

16. The Chartered Institute of Public Finance and Accountancy's Treasury Management Code (the CIPFA Code) requires the Council to approve a treasury management annual report after the end of each financial year. This report fulfils the Council's legal obligation to have regard to the CIPFA Code.
17. The Council's Treasury Management Strategy 2017/18 was approved by full Council on 24 February 2017. The Council has borrowed and invested large sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The identification, monitoring and control of risk are therefore central to the Council's treasury management strategy.
18. An economic commentary by the Council's Treasury Advisor, Arlingclose, can be found in Appendix B.

LOCAL AUTHORITY REGULATORY CHANGES

19. **Revised CIPFA Codes:** CIPFA published revised editions of the Treasury Management and Prudential Codes in December 2017. The required changes from the 2011 Code are being incorporated into Treasury Management Strategies and monitoring reports.
20. 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.
21. In the 2017 Treasury Management Code the definition of 'investments' has been widened to include financial assets as well as non-financial assets held primarily for financial returns such as investment property. These, along with other investments made for non-treasury management purposes such as loans supporting service outcomes and investments in subsidiaries, must be discussed in the Capital Strategy or Investment Strategy. Additional risks of such investments are to be set out clearly and the impact on financial sustainability is to be identified and reported.
22. These changes, including the Capital Strategy, will be incorporated into the 2019/20 Treasury Management Strategy for approval in February 2019.
23. **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 Investments and Statutory Guidance on Minimum Revenue Provision (MRP).
24. Changes to the Investment Guidance include a wider definition of investments to include non-financial assets held primarily for generating income return and a new category called "loans" (e.g. temporary transfer of cash to a third party, joint venture, subsidiary or associate). The Guidance introduces the concept of proportionality, proposes additional disclosure for borrowing solely to invest and also specifies additional indicators. Investment strategies must detail the extent to which service delivery objectives are reliant on investment income and a contingency plan should yields on investments fall.

25. The definition of prudent MRP has been changed to “put aside revenue over time to cover the CFR”. 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.
26. **MiFID II:** As a result of the second Markets in Financial Instruments Directive (MiFID II), from 3rd January 2018 local authorities were automatically treated as retail clients but could “opt up” to professional client status, providing certain criteria was met which includes having an investment balance of at least £10 million and the person(s) authorised to make investment decisions on behalf of the 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.
27. The Council has met the conditions to opt up to professional status and has done so in order to maintain its former MiFID II status prior to January 2018. The Council will continue to have access to products including money market funds, pooled funds, treasury bills, bonds, shares and to financial advice.

LOCAL CONTEXT

28. On 31 March 2018, the Council had net borrowing of £40 million arising from its revenue and capital income and expenditure, an increase on 2017 of £13.2m. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors and the year-on-year change are summarised in the table below.

	31 March 2017 Actual £'000	2017/18 Movement £'000	31 March 2018 Actual £'000
General Fund CFR	24,070	15,345	39,415
HRA CFR	51,141	-	51,141
Total CFR	75,211	15,345	90,556
Less: Usable reserves	(31,853)	(2,071)	(33,924)
Less: Working capital	(16,523)	(92)	(16,615)
Net borrowing	26,835	13,182	40,017

29. Net borrowing has increased due to a rise in the CFR as new capital expenditure was higher than the financing applied including minimum revenue provision; offset by an increase in usable reserves and a small rise in working capital due to the timing of receipts and payments.
30. The Council’s strategy was to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low. The treasury management position as at 31st March 2018 and the year-on-year change in shown in the table below.

	31 March 2017 Actual £'000	2017/18 Movement £'000	31 March 2018 Actual £'000
Long-term borrowing	40,000	-	40,000
Short-term borrowing	1,835	10,182	12,017
Total borrowing	41,835	10,182	52,017
Long-term investments	-	(2,000)	(2,000)
Short-term investments	(9,000)	2,000	(7,000)
Cash and cash equivalents	(6,000)	3,000	(3,000)
Total investments	(15,000)	3,000	(12,000)
Net borrowing	26,835	13,182	40,017

Note: the figures in the table are from the Balance Sheet in the Council's statement of accounts, but are adjusted to exclude operational cash, accrued interest and other accounting adjustments.

31. The increase in net borrowing in the table above has translated into a fall in investment balances due to the Council's internal borrowing policy.

BORROWING ACTIVITY

32. At 31 March 2018, the Council held £52 million of loans, an increase of £10.2 million on the previous year. The year-end borrowing position is shown in the table below.

	Balance on 31 March 2017 £'000	Balance on 31 March 2018 £'000	Average Rate
Long-term borrowing	40,000	40,000	3.50%
Short-term borrowing	-	10,000	0.89%
Portchester Crematorium	1,541	2,017	0.25%
Charity of Winifred Nellie Cocks	287	-	0.24%
Fareham Charity Account	7	-	0.00%
Total Borrowing	41,835	52,017	

33. The Council holds investments from Portchester Crematorium Joint Committee, the Charity of Winifred Nellie Cocks and the Fareham Charity Account which are treated as temporary loans. The funds of the Charity of Winifred Nellie Cocks were used during 2017/18 towards the funding of the Westbury Manor Museum remodelling scheme from the Council capital programme, as approved by the Executive on 6 June 2016. The funds of the Fareham Charity Account were used to purchase defibrillators installed at various community centres across the Borough.
34. The Council's main objective when borrowing has been to strike a low risk balance between securing low interest rates and achieving cost certainty over the period for which the funds are required. For the majority of the year the "cost of carry" analysis performed by the Council's treasury management advisor Arlingclose did not indicate value in borrowing in advance for future years' planned expenditure and therefore none was taken.

INVESTMENT ACTIVITY

35. The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During 2017/18 the Council's investment balances ranged between £10.6 million and £20 million due to timing differences between income and expenditure. The year-end position is shown in the table below.

	Balance on 31 March 2017 £'000	Balance on 31 March 2018 £'000	Average Rate
Banks and Building Societies	9,000	5,000	0.50%
Local Authorities	-	2,000	0.70%
Money Market Funds	6,000	3,000	0.28%
Local Authority Property Fund	-	2,000	0.00%
Total investments	15,000	12,000	

36. 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.
37. In furtherance of these objectives, and given the increasing risk and low returns from short-term unsecured bank investments, the Council diversified into a more secure and higher yielding asset class during 2017/18. £2 million that is available for longer-term investment was moved from bank and building society deposits into a pooled Local Authority Property Fund.
38. Guidance on Local Government Investments in England gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles.
39. Security of capital has remained the Council's main investment objective. This has been maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy for 2017/18.

INTEREST RECEIVED AND PAID

40. The net interest received in 2017/18 was £417,911 against a revised budget £474,900 million for the General Fund. Net interest paid for the Housing Revenue Account was £1,742,168 against a revised budget of £1,729,300.

COMMERCIAL PROPERTY INVESTMENT ACQUISITIONS

41. 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. The table below shows the current valuation of the commercial property investment acquisitions:

	Date of Purchase	Premises Type	Valuation £m
Clifton House, Segensworth	1 Aug 2013	Industrial	1,980
122-134 Seaside, Eastbourne	20 Dec 2013	Convenience Store	1,020
86-88 Mitcham Lane, Streatham	10 Mar 2014	Convenience Store	1,360
83 St Thomas St, Weymouth	29 Sept 2014	Retail	730
470 Ringwood Road, Poole	24 Nov 2014	Convenience Store	1,230
2 Armstrong Road, Oxford	20 Oct 2015	Nursery	1,980
136-138 Southampton Road, Park Gate	29 Feb 2016	Retail	7,535
Southampton Road Retail Park	16 Nov 2016	Retail	11,600
Total			27,435

42. The eight premises generated rental income of £1.7 million during 2017/18 at a weighted average return of 6.3%.

PRUDENTIAL AND TREASURY INDICATORS

43. During 2017/18, all treasury management activities complied fully with the CIPFA Code and the Council's approved Treasury Management Strategy. Appendix D shows the actual prudential and treasury indicators for 2017/18.

SUMMARY

44. This report gives details of General Fund capital and treasury management outturn in 2017/18 in accordance with the reporting requirements set out in the CIPFA Code of Practice for Treasury Management.

RISK ASSESSMENT

45. There are no significant risk considerations in relation to this report.

Enquiries:

For further information on this report please contact Caroline Hancock. (Ext 4589)

APPENDIX A

CAPITAL EXPENDITURE AND FINANCING 2017/18

	Budget	Actual	Savings	Additional	Carry
	£	£	£	Expenditure	over to
				£	2018/19
					£
STREETSCENE					
Health and Safety in Cemeteries	12,400	5,850			6,550
Holly Hill Cemetery Extension	30,000	25,489			4,511
Street Lighting Maintenance	1,100	1,113		13	0
Bus Shelter Improvements	49,100	7,616			41,484
Play Area Safety Equipment and Surface Replacement	35,000	26,116			8,884
Hook Recreation Ground Change of Use	2,100	9,913		7,813	0
STREETSCENE TOTAL	129,700	76,097	0	7,826	61,429
PLANNING AND DEVELOPMENT					
Car Park Surface Improvements	110,000	116,125			(6,125)
Hill Head Coastal Protection Phase 1	0	5,816		5,816	0
Hill Head Coastal Protection Phase 2	750,000	734,318			15,682
River Wallington Gabion Replacement Works	78,000	50,083	25,917		2,000
PLANNING AND DEVELOPMENT – TOTAL	938,000	906,342	25,917	5,816	11,557
LEISURE AND COMMUNITY					
Buildings					
Community Buildings Review	162,000	75,822			86,178
Holly Hill Leisure Centre	198,500	228,941		30,441	0
Westbury Manor Museum Remodelling	362,600	384,805			(22,205)
	723,100	689,568	0	30,441	63,973
Play and Parks Schemes					
Newtown Play Area	25,000	20,093	4,907		0
Sarisbury Green Play Area	25,000	21,097	3,903		0
Howerts Close Play Area	18,500	2,300	16,200		0
Holly Hill Play Area	280,000	281,875		1,875	0
	348,500	325,365	25,010	1,875	0
Outdoor Recreation Schemes					
Leigh Road Tennis Courts Conversion to Car Park	3,600	4,453		853	0
	3,600	4,453	0	853	0
Grants to Community Groups					
1st Sarisbury Scout Group	25,000	0			25,000
	25,000	0	0	0	25,000
Other					
Allotment Improvements	5,000	0			5,000
Footpath Improvements	10,000	0			10,000
	15,000	0	0	0	15,000
LEISURE AND COMMUNITY - TOTAL	1,115,200	1,019,386	25,010	33,169	103,973

	Budget £	Actual £	Savings £	Additional Expenditure £	Carry over to 2018/19 £
HOUSING					
Home Improvement Schemes					
Disabled Facilities Grants	732,500	505,792			226,708
Home Improvement Loans	96,100	13,812			82,288
	828,600	519,604	0	0	308,996
Enabling					
Empty Homes Strategy	75,100	75,923			(823)
Feasibility Studies	0	49,221		49,221	0
	75,100	125,144	0	49,221	(823)
HOUSING - TOTAL	903,700	644,748	0	49,221	308,173
POLICY AND RESOURCES					
Replacement Programmes					
Vehicles and Plant Replacement Programme	800,000	894,661			(94,661)
ICT Development Programme	280,000	159,854			120,146
	1,080,000	1,054,515	0	0	25,485
Operational Buildings					
Depot Refurbishment Works	15,000	16,749		1,749	0
Civic Offices Improvement Programme	76,300	103,092			(26,792)
	91,300	119,841	0	1,749	(26,792)
Daedalus					
Daedalus Development	8,219,100	7,552,308	28,589		638,203
Daedalus Plot Acquisition	4,177,000	4,177,000			0
Fareham Innovation Centre Phase 2	6,861,600	6,824,111			37,489
	19,257,700	18,553,419	28,589	0	675,692
Other Schemes					
Acquisition of Welborne Properties	830,300	865,794		35,494	0
Town Centre Hotel	60,000	54,976			5,024
	890,300	920,770	0	35,494	5,024
POLICY AND RESOURCES - TOTAL	21,319,300	20,648,545	28,589	37,243	679,409
GENERAL FUND - TOTAL	24,405,900	23,295,118	79,516	133,275	1,164,541

ECONOMIC COMMENTARY BY TREASURY ADVISORS ARLINGCLOSE

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

The UK economy 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.

The Bank of England's Monetary Policy Committee (MPC) increased Bank Rate by 0.25% in November 2017. It was significant in that it was the first rate hike in ten years, although in essence the MPC reversed its August 2016 cut following the referendum result. The February *Inflation Report* indicated the MPC was keen to return inflation to the 2% target over a more conventional (18-24 month) horizon with 'gradual' and 'limited' policy tightening. Although in March two MPC members voted to increase policy rates immediately and the MPC itself stopped short of committing itself to the timing of the next increase in rates, the minutes of the meeting suggested that an increase in May 2018 was highly likely.

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

Financial markets: The increase in Bank Rate resulted in higher money markets rates: 1-month, 3-month and 12-month LIBID rates averaged 0.32%, 0.39% and 0.69% and at 31st March 2018 were 0.43%, 0.72% and 1.12% respectively.

Gilt yields displayed significant volatility over the twelve-month period with the change in sentiment in the Bank of England's outlook for interest rates. The yield on the 5-year gilts which had fallen to 0.35% in mid-June rose to 1.65% by the end of March. 10-year gilt yields

also rose from their lows of 0.93% in June to 1.65% by mid-February before falling back to 1.35% at year-end. 20-year gilt yields followed an even more erratic path with lows of 1.62% in June, and highs of 2.03% in February, only to plummet back down to 1.70% by the end of the financial year.

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

Credit background:

Credit Metrics

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 Authority would be dealing with once ring-fencing was implemented and what the balance sheets of the ring-fenced and non ring-fenced entities would 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.

PRUDENTIAL AND TREASURY INDICATORS 2017/18

PRUDENTIAL INDICATORS

1) Capital Expenditure

The Council's capital expenditure and financing is summarised as follows:

Capital Expenditure and Financing	2017/18 Revised £'000	2017/18 Actual £'000	Difference £'000
Health & Public Protection	0	0	0
Streetscene	130	76	54
Leisure & Community	1,115	1,019	96
Housing	904	645	259
Planning & Development	938	906	32
Policy & Resources	21,319	20,649	670
Total General Fund	24,406	23,295	1,111
HRA	2,584	3,036	(452)
Total Expenditure	26,990	26,331	659
Capital Receipts	294	344	(50)
Capital Grants	5,946	5,147	799
Capital Reserves	3,600	2,605	995
Revenue	1,205	2,475	(1,270)
Borrowing	15,945	15,760	185
Total Financing	26,990	26,331	659

2) Capital Financing Requirement

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

£'000	2016/17 Actual	2017/18 Revised	2017/18 Actual	2017/18 Difference
General Fund	24,070	37,356	39,415	-2,059
HRA	51,141	50,911	51,141	-230
Total CFR	75,211	88,267	90,556	-2,289

The CFR rose by £15.3m as capital expenditure financed by debt outweighed resources put aside for debt repayment.

3) Gross Debt and the Capital Financing Requirement

In order to ensure that over the medium-term debt will only be for a capital purpose, the Council should ensure that debt does not, except in the short term, exceed the total of capital financing requirement. This is a key indicator of prudence.

£'000	2017/18 Revised	2017/18 Actual	Difference
Capital Financing Requirement	88,267	90,556	-2,289
Less: Gross Debt	51,835	52,017	-182
Under/(Over) Borrowing	36,432	38,539	-2,107

Total debt remained below the Capital Financing Requirement during the forecast period.

4) Operational Boundary and Authorised Limit for External Debt

The **operational boundary** is based on the Council's estimate of the most likely (i.e. prudent but not worst case) scenario for external debt. It links directly to the Council's estimates of capital expenditure, the capital financing requirement and cash flow requirements, and is a key management tool for in-year monitoring.

The **authorised limit** is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Council can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

£'000	2017/18 Revised	2017/18 Actual	Complied
Operational Boundary			
Borrowing	56,000	52,017	✓
Other long term liabilities	5,000	3,468	✓
Total	61,000	55,485	✓
Authorised Limit			
Borrowing	89,000	52,017	✓
Other long term liabilities	7,000	3,468	✓
Total	96,000	55,485	✓

Separately, the Council is also limited to a maximum HRA CFR through the HRA self-financing regime. This limit is currently:

£'000	2017/18 Revised	2017/18 Actual	Difference
HRA Debt Cap	56,851	56,851	-
HRA CFR	50,911	51,141	-230
HRA Headroom	5,940	5,710	-230

5) Financing Costs as % of 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, net of investment income.

The positive percentage for the Housing Revenue Account (HRA) reflects the net borrowing costs for the HRA settlement.

	2017/18 Revised	2017/18 Actual	Difference
General Fund	0%	0%	-
HRA	14%	14%	-
Total	8%	8%	-

6) Housing Revenue Account (HRA) Ratios

As a result of the HRA Reforms in 2012, the Council moved from a subsidy system to self-financing and was required to take on £49.3 million of debt. The table below shows additional local indicators relating to the HRA in respect of this debt.

	2017/18 Revised	2017/18 Actual	Difference
HRA debt £'000	49,268	49,268	-
HRA revenues £'000	11,250	10,989	261
Number of HRA dwellings	2,405	2,411	-6
Ratio of debt to revenues %	4.38:1	4.48:1	0.10:1
Debt per dwelling £	£20,846	£20,435	-£411

TREASURY MANAGEMENT INDICATORS

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

1) Interest Rate Exposures

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

Upper limits on interest rate exposures	2017/18 Revised	2017/18 Actual	Complied
	%	%	
- Upper limit on variable interest rate exposures	25	11	✓
- Upper limit on fixed interest rate exposures	100	89	✓

2) Maturity Structure of Borrowing

This indicator is set to control the Council's exposure to refinancing risk. The upper limits on the maturity structure of fixed rate borrowing were:

Maturity structure of borrowing	Upper Limit	2017/18 Actual	Complied
	%	%	
- Loans maturing within 1 year	25	23	✓
- Loans maturing within 1 - 2 years	25	0	✓
- Loans maturing within 2 - 5 years	25	0	✓
- Loans maturing within 5 - 10 years	50	0	✓
- Loans maturing in over 10 years	100	77	✓

3) Principal Sums Invested for Periods Longer than 364 Days

The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum insured to final maturities beyond the period end were:

£M	2017/18 Revised	2017/18 Actual	Complied
Principal sums invested > 364 days	10	2	✓