

London Borough of Barnet

**Annual Treasury Management Out-
turn Review**

2017/18

Annual Treasury Management Review 2017/18

1. Introduction

This Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2017/18. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management, (the Code), and the CIPFA Prudential Code for Capital Finance in Local Authorities, (the Prudential Code).

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

- an annual treasury strategy in advance of the year (Council 7th March 2017)
- a mid-year (minimum) treasury update report (Performance and Contract Management Committee 28 November 2017)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

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

This Council confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by either the Policy and Resources Committee or the Performance and Contract Management Committee before they were reported to the full Council. Member training on treasury management issues was undertaken during the year on 13th February 2018 in order to support members' scrutiny role.

2. Summary

Debt

There was no new borrowing during the year, with a small reduction in PFI balances. Gross debt declined by £0.4 million to £320.1 million. Capital expenditure requiring funding by debt / internal balances was £23.5 million, much lower than the TMSS projection of £199.9 million.

Investments

Investment balances increased modestly to £95.5 million compared with £80.2 million at the start of the year.

TMSS Limits

There were no breaches of limits during the year to 31 March 2018.

3. The Economy and Interest Rates

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

The 8 February 2018 MPC meeting minutes then revealed another sharp hardening in MPC warnings on a more imminent and faster pace of increases in Bank Rate than had previously been expected. Market expectations for increases in Bank Rate, therefore, shifted considerably during the second half of 2017-18 and resulted in investment rates from 3 – 12 months increasing sharply during the spring quarter.

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

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

4. Overall Treasury Position as at 31 March 2018

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

TABLE 1	31 March 2017 Principal £'000	Rate/ Return %	Average Life 27.5 yrs	31 March 2018 Principal £'000	Rate/ Return %	Average Life 26.5 yrs
debt	304,080	3.86		304,080	3.86	
Other long-term liabilities	16,402			15,974		
Total debt	320,482			320,054		
CFR	435,651			459,166		
Over / (under) borrowing	-115,169			-139,112		
Total investments	80,200	0.54	30 days	95,500	0.52	47 days
Net debt	240,282			224,554		

5. The Strategy for 2017/18

The expectation for interest rates within the treasury management strategy for 2017/18 anticipated that Bank Rate would not start rising from 0.25% until quarter 2 2019 and then only increase once more before 31.3.20. There would also be gradual rises in medium and longer term fixed borrowing rates during 2017/18 and the two subsequent financial years. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period. Continued uncertainty in the aftermath of the 2008 financial crisis promoted a cautious approach, whereby investments would continue to be dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates. Investment maturities were maintained short to ensure that cash was available to finance capital expenditure. In this scenario, the treasury strategy was to postpone borrowing to avoid the cost of holding higher levels of investments and to reduce counterparty risk.

During 2017/18, longer term PWLB rates were volatile but with little overall direction, whereas shorter term PWLB rates were on a rising trend during the second half of the year. There were no changes in the treasury strategy during the year.

6. The Borrowing Requirement and Debt

The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR). The table below summarises the opening, projected and closing capital positions.

	31-Mar-17 Actual	31-Mar-18 Budget	31-Mar-18 Actual
CFR General Fund (£'000)	235,017	409,939	258,532
CFR HRA (£'000)	200,634	228,145	200,634
Total CFR (£'000)	435,651	638,084	459,166

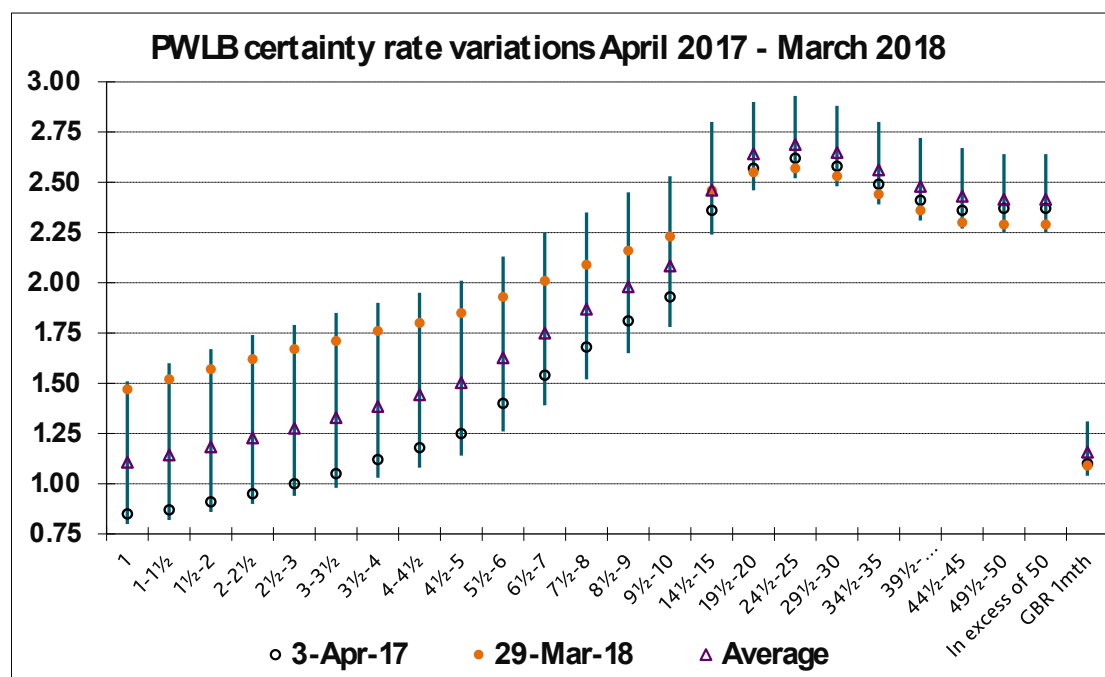
7. Borrowing Rates in 2017/18

PWLB certainty maturity borrowing rates

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

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

The graph shows the high and low points in rates, spreads and individual rates at the start and the end of the financial year.



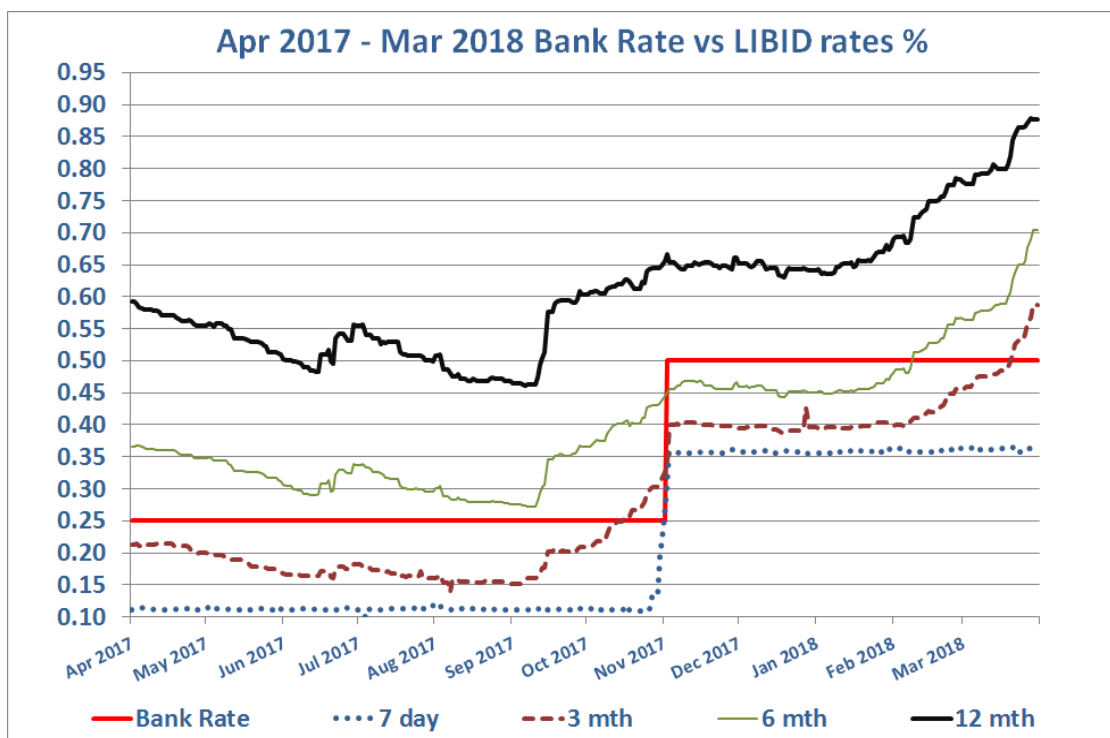
8. Borrowing Outturn for 2017/18

There were no changes in the Council debt during the year, with no repayments or new advances. The value of debt was £304.08 million throughout the year. In addition, there was £15.974 million of PFI liabilities as at 31 March 2018.

The TMSS forecast closing gross borrowing of £504.0 million, derived from £199.9 million of debt funded capital expenditure. The value of capital expenditure funded by internal cash during the year was considerably lower at £23.5 million.

9. Investment Rates in 2017/18

Investments rates for 3 months and longer have been on a rising trend during the second half of the year in the expectation of Bank Rate increasing from its floor of 0.25%, and reached a peak at the end of March. Bank Rate was duly raised from 0.25% to 0.50% on 2 November 2017 and remained at that level for the rest of the year. However, further increases are expected over the next few years. Deposit rates continued into the start of 2017/18 at previous depressed levels due, in part, to a large tranche of cheap financing being made available under the Term Funding Scheme to the banking sector by the Bank of England; this facility ended on 28 February 2018.



10. Investment Outturn for 2017/18

Investment Policy – the Council’s investment policy is governed by MHCLG guidance, which has been implemented in the annual investment strategy approved by the Council on 7 March 2017. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data, (such as rating outlooks, credit default swaps, bank share prices etc.).

The investment activity during the year conformed to the approved strategy, and the Council had retained sufficient cash balances to meet all its obligations on time.

Investments held by the Council - the Council maintained an average balance of £98.8 million of internally managed funds. The internally managed funds earned an average rate of return of 0.52%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.21%. This compares with a budget assumption of £100 investment balances earning an average rate of 0.25%.

11. Other Issues

1. Revised CIPFA Codes

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

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

investments. Officers will report to members when the implications of these new codes have been assessed as to the likely impact on this Authority.

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

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

Appendix 1: Prudential and treasury indicators

The table below compares the prudential indicators set out at the start of 2017-18 with those achieved at 31st March 2018.

1. PRUDENTIAL INDICATORS	2016/17	2017/18	2017/18
	actual	original	actual
	£'000	£'000	£'000
Capital Expenditure			
Non - HRA	99,485	306,686	115,514
HRA (applies only to housing authorities)	37,826	77,118	49,378
TOTAL	137,311	383,804	164,892
Financing of Capital Expenditure			
Capital receipts	26,435	59,182	32,706
Capital grants	29,459	56,124	60,886
Capital reserves	20,749	47,554	7,598
Revenue	27,769	37,018	40,187
Total	104,412	199,878	141,377
Net Financing Need for the Year	32,899	183,926	23,515
Ratio of financing costs to net revenue stream			
Non - HRA (ex PFI)	3.87%	5.75%	4.54%
HRA	11.52%	15.16%	11.77%
Gross borrowing as at 31 March			
Non - HRA	120,981	283,522	120,553
HRA	199,501	220,518	199,501
Total	320,482	504,040	320,054
CFR			
Non – HRA	235,017	409,939	258,532
HRA	200,634	228,145	200,634
TOTAL	435,651	638,084	459,166

NB: Ratio of financing costs as a proportion of net revenue stream - this indicator identifies the trend in the cost of capital (borrowing and other long-term obligation costs net of investment income) against the net revenue stream. The increase between 2016/17 and 2017/18 is due to higher MRP charges in the later year. The TMSS ratio has been restated due to a calculation error – previously reported as 4.41%.

2. TREASURY MANAGEMENT INDICATORS	2016/17	2017/18	2017/18
	actual	TMSS limits	actual
	£'000	£'000	£'000
Authorised Limit for external debt -			
borrowing	304,080	598,029	304,080
other long-term liabilities	16,402	31,034	15,974
TOTAL	320,482	629,063	320,054
Operational Boundary for external debt -			
borrowing	304,080	598,029	304,080
other long-term liabilities	16,402	16,034	15,974
TOTAL	320,482	614,063	320,054
HRA Debt Limit			
HRA debt Cap	240,643	240,043	240,643
HRA CFR	200,634	228,145	200,634
HRA headroom	40,009	11,898	40,009
Upper limit for fixed interest rate exposure	100%	100%	100%
Upper limit for variable rate exposure	0%	30%	0%
Upper limit for total principal sums invested for over 364 days	nil	150,000	nil

The authorised limit - the authorised limit is the “affordable borrowing limit” required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level. The table below demonstrates that during 2017/18 the Council has maintained gross borrowing within its authorised limit.

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

3. Maturity Profile of Debt	31-Mar-17	2017/18	31-Mar-18
	actual	TMSS Upper limits	actual
Under 12 months	0%	50%	0%
12 months and within 24 months	0%	50%	0%
24 months and within 5 years	0%	75%	0%
5 years and within 10 years	0.7%	75%	7.4%
10 years and within 60 years	99.3%	100%	92.6%