CABINET
11 SEPTEMBER 2018

ITEM NO. ....

TREASURY MANAGEMENT ANNUAL REPORT AND OUTTURN PRUDENTIAL INDICATORS 2017/18

Responsible Cabinet Member - Councillor Stephen Harker, Efficiency and Resources Portfolio

Responsible Director - Paul Wildsmith, Managing Director

SUMMARY REPORT

Purpose of the Report

1. This report provides important information regarding the regulation and management of the Council's borrowing, investments and cash-flow. It is a requirement of the Council's reporting procedures and covers treasury activity for 2017/18. The report also seeks approval of the Prudential Indicators results for 2017/18 in accordance with the Prudential Code.

Summary

2. The financial year 2017/18 presented similar circumstances to 2016/17 with regard to treasury management. However, due to the low returns for cash investments new ways to improve investment returns were sought. It was agreed to look at alternative investment types to increase return. Cost of borrowing remained low throughout 2017/18 and the cost of shorter term borrowing will remain low for a number of years in the future.

3. During 2017/18 the Council complied with its legislative and regulatory requirements. The borrowing need (Table 1) was only increased for capital purposes.

4. At 31st March 2018 the Council's external debt was £160.161M which is £33.000M more than the previous year, this increase relates to externalising debt which was in the past internal i.e. use of reserves. This externalisation enabled the Council to invest in Property Fund units to increase investment return. The average interest rate for borrowing was down from 4.30% in 2016/17 to 3.84% in 2017/18. This reduction in the average rate of interest is due to a new mix of maturity dates to take advantage of the lower cost of borrowing for short term debt. Investments totalled £52.443M at 31st March 2018 (£21.000M at 31st March 2017) earning interest of 0.31% on short term cash investments, 0.625% on longer term cash investments and 2.2% on Property Fund units net of costs.

5. Financing costs have been reduced during the year and a saving of £0.600M achieved from the original MTFP. The majority of the savings relate to the inclusion and purchase of Property Fund units in the investment portfolio, with the interest received reduced due to additional interest payments on debt and additional brokerage fees.

Recommendation

6. It is recommended that:

   (a) The outturn 2017/18 Prudential Indicators within this report and those in **Appendix 1** be noted.

   (b) The Treasury Management Annual Report for 2017/18 be noted.

   (c) This report to be forwarded to Council, in order for the 2017/18 Prudential Indicators to be noted.

Reasons

7. The recommendations are supported by the following reasons:

   (a) In order to comply with the Prudential Code for Capital Finance in Local Authorities.

   (b) To inform members of the Performance of the Treasury Management function.

   (c) To comply with the requirements of the Local Government Act 2003.

Paul Wildsmith
Managing Director

Background Papers

(i) Accounting Records
(ii) Annual Investment Strategy 2017/18
(iii) Prudential Indicators and Treasury Management Strategy Report 2017/18

Elaine Hufford : Extension 5404

S17 Crime and Disorder	This report has no implications for crime and disorder
Health and Well Being	There are no issues relating to health and wellbeing which this report needs to address
Carbon Impact	There are no issues relating to carbon impact
Diversity	There are no specific implications for diversity
Wards Affected	The proposals affect all wards
Groups Affected	The proposals do not affect any specific group
Budget and Policy Framework	The report does not change the Council's budget or Policy framework but needs to be considered by Council
Key Decision	This is not an Executive decision
Urgent Decision	This is not an Executive decision
One Darlington: Perfectly Placed	The proposals in the report support delivery of the Community Strategy through appropriate and effective deployment of the Councils Resources
Efficiency	The report outlines movements in the national economic outlook that have enabled officers to take advantage of different types of Investments and changing interest rates to benefit the Revenue MTFP.
Impact on Looked After Children and Care Leavers	Does this report impact on Looked After Children or Care Leavers

MAIN REPORT

Information and Analysis

8. This report summarises:

   (a) Capital expenditure and financing for 2017/18
   (b) The Council's underlying borrowing need
   (c) Treasury position at 31st March 2018
   (d) Prudential indicators and compliance issues
   (e) The economic background for 2017/18
   (f) A summary of the Treasury Management Strategy agreed for 2017/18
   (g) Treasury Management activity during 2017/18
   (h) Performance and risk benchmarking

9. Throughout this report a number of technical terms are used, a glossary of terms can be found at the end of this report.

The Council's Capital Expenditure and Financing 2017/18

10. The Council undertakes capital expenditure on long term assets, which is financed either,

    (a) immediately through capital receipts, capital grants, contributions and from revenue; or
    (b) by borrowing.

11. Part of the Council's treasury activities is to address this borrowing need, either through borrowing from external bodies, or utilising temporary cash resources within the Council. The wider treasury activities also include managing the Council's cash flow, its previous borrowing activities and the investment of surplus funds. These activities are structured to manage risk foremost and then optimise performance.

12. Capital Expenditure forms one of the prudential indicators that are used to regulate treasury activity. Table 1 shows total capital expenditure and how this was financed, compared with what was expected to be spent and how this would have been financed. Actual expenditure was £98.973M less than planned, mainly due to not progressing the Loan Facility to Registered Social Landlords (RSL's). However the mix of funding differs from that which was expected as some schemes progressed quicker than others. This impacted slightly on borrowing needed to fund expenditure, resulting in £0.402M less borrowing need than expected at this time which excludes any loans to RSL's.

Table 1 – Capital Expenditure and Financing

	2016/17	2017/18		
	Outturn £m	**Revised Estimate £m**	**Outturn £m**	**Variance £m**
General Fund Capital Expenditure	19.911	22.240	24.797	2.557
HRA Capital Expenditure	14.185	17.164	15.634	-1.530
Loan Facility to RSL's		100.000	0	-100.000
Total Capital Expenditure	**34.096**	**139.404**	**40.431**	**-98.973**
Resourced by:				
Capital Receipts GF	1.464	3.093	5.534	2.441
Capital receipts Housing	0.641	0.000	0.985	0.985
Capital Grants	14.275	10.194	13.349	3.155
Capital Contributions	0.220	1.829	1.716	-0.113
Revenue	0.872	2.475	0.000	-2.475
Revenue (Housing)	11.743	15.988	13.424	-2.564
Total Resources	**29.215**	**33.579**	**35.008**	**1.429**
Borrowing needed to finance expenditure	**4.881**	**105.825**	**5.423**	**-100.402**

The Council's Underlying Borrowing Need

13. The Council's underlying need to borrow is called the Capital Financing Requirement (CFR). The figure is a gauge for the Council's debt position. It represents 2017/18 and prior years' net capital expenditure which has not yet been paid for by revenue or other resources.

14. The General Fund element of the CFR is usually reduced each year by a statutory charge to the revenue accounts called the Minimum Revenue Provision (MRP). The total CFR can also be reduced each year through a Voluntary Revenue Provision (VRP).

15. The Council's CFR for the year is shown in table 2, and represents a key prudential indicator. The CFR outturn for 2017/18 is £198.788M which is £100.402M lower than approved because of the lower borrowing need than expected for 2017/18. No MRP repayments were made on the General Fund debt in line with the report to Council on 23rd February 2017.

Table 2 - Capital Financing Requirement

	2016/17	2017/18		
	Outturn £m	Approved Indicator £m	31 March Actual £m	Variance £m
Opening Balance	175.917	180.169	180.169	0.00
Add adjustment for the inclusion of leases on the balance sheet under IFRS	16.230	15.017	15.017	0.00
Add Capital Expenditure financed by borrowing	4.881	105.825	5.423	-100.402
Less MRP/VRP General Fund			0	
Less MRP/VRP Housing	-0.629	-0.629	-0.629	0.00
Less MRP/VRP PFI	-1.213	-1.192	-1.192	0.00
Closing balance	**195.186**	**299.190**	**198.788**	**-100.402**

Treasury Position at 31 March 2018

16. Whilst the measure of the Council's underlying need to borrow is the CFR, the Assistant Director of Resources can manage the Council's actual borrowing position by:

    (a) borrowing to the CFR level; or
    (b) choosing to utilise some temporary cash flows instead of borrowing ("under borrowing"); or
    (c) borrowing for future increases in CFR (borrowing in advance of need, the "over borrowed" amount can be invested).

17. The financial reporting practice that the Council is required to follow (the Statement of Recommended Practice (SORP)), changed in 2007/08. Financial instruments (borrowing and investments etc.) must now be reported in the Statement of Accounts in accordance with national Financial Reporting Standards. The figures in this report are based on actual amounts borrowed and invested and so will differ from those in the Statement of Accounts.

18. The Council's total debt outstanding at 31st March 2018 was £160.161M. In addition to this, a liability of £13.825M relating to the PFI scheme and Finance Leases brings the total to £173.986M. The Council's revised CFR position was estimated to be £299.190M, which included £100.000M that related to possible loans to RSL's which were not realised in 2017/18. However, the actual out turn position was £198.788M. When comparing this to our actual borrowing of £173.986M this meant that the Council was "under borrowed" by £24.802M this "under borrowed" amount was financed by internal borrowing this means that the amount that could have been invested externally was reduced to cover this. The amount of under borrowing has reduced from 2016/17 to enable external investments to be made in Property Funds. The reduced under borrowed position still has the dual effect of reducing costs to the MTFP because borrowing costs are

generally greater than investment returns and it reduces counterparty risk by reducing our exposure to banks and other financial institutions.

19. The treasury position at the 31st March 2018, including investments compared with the previous year is shown in table 3 below.

Table 3 – Summary of Borrowing and Investments

Treasury Position	31 March 2017		31 March 2018	
	Principal £m	Average Rate %	Principal £m	Net annualised Average Rate %
General Debt - Fixed Rate Debt, Market and Public Works Loan Board (PWLB)	127.161	4.30%	135.161	4.08%
Property Fund Borrowing			25.000	1.17%
Total Debt	**127.161**	**4.30%**	**160.161**	**3.84%**
Cashflow Investments up to 6 months	12.000	0.44%	21.000	0.31%
Capital Investments over 6 months	9.000	0.79%	2.000	0.625%
Property Fund Investment -net of costs			29.433	2.2%
Total Investments	**21.000**		**52.433**	
Net borrowing position	**106.161**		**107.728**	

Prudential Indicators and Compliance Issues

20. Some prudential indicators provide an overview while others are specific limits on treasury activity. These indicators are shown below:

21. **Gross Borrowing and the CFR –** Over the medium term the Council's external borrowing, net of investments, must only be for capital purposes. Gross borrowing should therefore not, except in the short term, have exceeded the CFR for 2017/18 plus the expected changes to the CFR over 2018/19 and 2019/20 Table 4 highlights the Council's Gross borrowing position against CFR. The Council has complied with this prudential indicator.

Table 4 – Gross Borrowing Compared with CFR

	31 March 2016 Actual £m	31 March 2018 Approved Indicator £m	31 March 2018 Actual £m
Gross Borrowing Position	**127.161**	**282.000**	**160.161**
CFR Excluding PFI & leases	**180.169**	**285.365**	**184.963**
CFR	**195.186**	**299.190**	**198.788**

22. **The Authorised Limit –** The Authorised Limit is the “Affordable Borrowing Limit” required by section 3 of the Local Government Act 2003. The Council does not have power to borrow above this level.

23. **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 are both acceptable, subject to the Authorised Limit not being breached.

24. **Actual financing costs as a proportion of net revenue expenditure -** 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 expenditure. The actual for this indicator has reduced due to nil provision of MRP for the General Fund and other savings in the Financing Costs budget, but has risen from the previous year due to a reduction in the Councils overall budget.

Table 5 – Key Prudential Indicators

	Actual 2016/17 £M	Original Approved Limits 2017/18 £M	Revised Approved Limits 2017/18 £M	Actual Total Liabilities Borrowing + PFI/ leases 2017/18 Maximum £M
Approved Indicator – Authorised Limit	**142.178**	**205.616**	**310.616**	**173.986**
Approved Indicator – Operational Boundary	**142.178**	**195.825**	**295.825**	**173.986**
Financing costs as a percentage of net revenue expenditure	**4.19%**	**4.65%**	**4.01%**	**4.00%**

25. At 31st March 2018 the total liabilities were £173.986m which is below both the approved Authorised Limit and the approved Operational Boundary. The Operational Boundary is the point at which we expect borrowing to be, but it can be lower or higher. Borrowing cannot exceed the Authorised Limit.

26. A further four prudential indicators are detailed in **Appendix 1**.

Economic Background for 2017/18

27. A summary of the general economic conditions that have prevailed through 2017/18 provided by Link Asset Services, the Council’s treasury management advisors is attached at **Appendix 2.**

Summary of the Treasury Management Strategy agreed for 2017/18

28. The revised Prudential Indicators anticipated that during 2017/18 the Council would need to borrow £105.825M to finance part of its capital programme including £100.000M of loans to RSL's.

29. The Annual Investment Strategy stated that the use of specified (usually less than 1 year) and non-specified (usually more than 1 year) investments would be carefully balanced to ensure that the Council has appropriate liquidity for its operational needs. In the normal course of the Council's business it is expected that both specified and non-specified investments will be utilised for the control of liquidity as both categories allow for short term investments.

30. Longer term instruments (greater than one year from inception to repayment) will only be used where the Council's liquidity requirements are safeguarded. An estimate of long term investments (over 1 year) were included in the report on the Prudential Indicators update these were as follows £30M for 2017/18, £50M for 2018/19 and £50M for 2019/20. Three investments of up to £10m each were made in 3 Property Funds during July August and December 2017. No other investments of over 1 year duration have been made during 2017/18.

Treasury Management Activity during 2017/18

Debt Position

31. **Borrowing –** this increased during 2017/18 by £33.000M in total

	PWLB			Market Loans (incl. other Local Authorities			Total
	Amount £M	Length of Loan	Interest Rate	Amount £M	Length of Loan	Interes t Rate	£M
New Loans taken							
	8.500	5 years	1.38%	5.000	1 year	0.53%	
	8.000	10 years	2.01%	5.000	1 year	0.42%	
	5.000	11 years	2.20%	3.500	1 year	0.46%	
				5.000	1 year	0.50%	
				5.000	2years	0.80%	45.000
Loans Repaid							
				-5.000	15years	3.82%	
				-5.000	2years	0.80%	
				-2.000	2years	0.99%	-12000
Total New Borrowing	21.500			11.500			33.000

32. The new borrowing of £33.000m was taken for various lengths of time at various interest rates as shown above.

33. **Rescheduling –** 1 loan of £5m with 11 years remaining at an interest rate of 3.82% was repaid early and replaced with a loan for 11 years at 2.20% producing net annual savings to the Council of £68.000 for the next 11 years.

34. **Summary of Debt Transactions –**The consolidated rate of interest decreased from 4.30% to 3.84% due to the above transactions.

Investment Position

35. **Investment Policy –** the Council's investment policy for 2017/18 is governed by the DCLG Guidance which has been implemented in the annual investment strategy for 2017/18 approved by Council on 23 February 2017.

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

37. Investments held by the Council consist of temporary surplus balances, capital receipts and other funds.

Table 6 - Temporary Surplus Cash Balances up to 6 months

	Original Budget 2017/18	**Revised Budget 2017/18**	**Actual 2017/18**
Monthly Average level of Investments	**£8.878M**	**£18.500M**	**£20.000M**
Average Rate of Return on Investment	**0.35%**	**0.20%**	**0.31%**
Interest Earned	**£31,000**	**£37,000**	**£61,000**

Table 7a – Longer Term 6 months to 5 years Cash

	Original Budget 2017/18	**Revised Budget 2017/18**	**Actual 2017/18**
Monthly Average level of Investments	**0.00**	**£3.800M**	**£4.500M**
Average Rate of Return on Investment	**0.00%**	**0.50%**	**0.53%**
Interest Earned	**0.000**	**£19,000**	**£23,900**

Table 7b – Longer Term 6 months to 5 years - Property Funds

	Original Budget 2017/18	Revised Budget 2017/18	Actual 2017/18
Monthly Average level of Investments	**0.0**	**£15.379M**	**£15.379M.**
Average Rate of Return on Investment (gross)	**0.0**	**3.62%**	**3.72%**
Interest Earned (Gross)	**0.0**	**£557,000**	**£571,600**

Performance and Risk Benchmarking

38. A regulatory development is the consideration and approval of security and liquidity benchmarks. Yield benchmarks are currently widely used to assess investment performance and these are shown in **Table 10**. Discrete security and liquidity benchmarks are relatively new requirements to the member reporting. These were first set in the Treasury Strategy report of the 25th February 2010.

39. The following reports the current position against the benchmarks originally approved.

40. Security – The Council's maximum security risk benchmarks for the current portfolio of investments, when compared to historic default tables was set as follows:

    0.077% historic risk of default when compared to the whole portfolio

41. **Table 8** shows that there has been a reduction in the historic levels of default over the year. This is mainly due to some longer term investments actually being made for shorter terms i.e. up to six months rather than 1 year as these investments were better value than longer term investments and were also a better fit with how the council was expecting to utilise investments. It also shows more emphasis being placed on counterparties with a higher credit rating.

42. The investment portfolio was maintained within this overall benchmark during this year as shown in **Table 8**.

Table 8

Maximum	Benchmark 2017/18	Actual June 2017	Actual October 2017	Actual January 2018	Actual March 2018
Year 1	0.077%	0.013%	0.013%	0.007%	0.007%

43. The counterparties that we use are all high rated therefore our actual risk of default based on the ratings attached to counterparties is virtually nil.

44. Liquidity – In respect of this area the Council set liquidity facilities/benchmark to maintain

    (a) Bank Overdraft £0.100M
    (b) Liquid short term deposits of at least £3.000M available within a weeks' notice.
    (c) Weighted Average Life benchmark is expected to be 146 days with a maximum of 1year.

45. Liquidity arrangements have been adequate for the year to date as shown in Table 9.

Table 9

	Benchmark	**Actual June 2017**	**Actual October 2017**	**Actual January 2018**	**Actual March 2018**
Weighted Average life	**146days to 1 years**	**132 days**	**103 days**	**111 days**	**83days**

46. This benchmark includes fixed term investments are for up to 1 year with cash flow monies being invested in Money Market funds which can be accessed immediately.

47. Yield - In respect of this area performance indicators relating to interest rates for borrowing and investments were set with reference to comparative interest rates. For borrowing, the indicator is the average rate paid during the year compared with the previous year. Investment rates are compared with a representative set of comparative rates.

Table 10 – Performance Compared With Indicators

Borrowing	Average overall rate paid compared to previous years	**2016/17 4.30%**	**2017/18 3.84%**
Investments		**DBC 2016/17**	**DBC 2017/18**
Short term	Cash flow investment rate returned against comparative average rate	0.44%	**0.31%**
Long term	Capital investment rate returned against comparative average rates	0.79%	**0.53%**

Comparative rates used to compare DBC performance: -	**Short Term Investments**	**Long Term Investments**
Comparative Rates		
Overnight Bid Rate Overnight	0.20%	-
London Interbank Bid Rate 7 day	0.22%	-
London Interbank Bid Rate 1 month	0.23%	
London Interbank Bid rate 3 months	0.29%	
London Interbank Bid rate 6 months	-	0.40%
London Interbank Bid rate 12 months	-	0.60%
Average External Comparators	**0.24%**	**0.50%**

48. As can be seen from the table, the actual investment rate achieved for both short and longer term investments exceeds the average of comparative rates.

Risk

49. The Council's treasury management activities are regulated by a variety of professional codes, statutes and guidance:-

(a) The Local Government Act 2003(the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity.

(b) The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions were made in 2017/18).

(c) Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act.

(d) The SI requires the Council to undertake any borrowing activity with regard to the CIFPA Prudential Code for Capital Finance in Local Authorities.

(e) The SI also requires the Council to operate the overall treasury function with regard to the CIPFA code of Practice for Treasury Management in Public Services.

(f) Under the Act the Department for Communities and Local Government has issued Investment Guidance to structure and regulate the Council's investment activities.

(g) Under section 238(2) of the Local Government and Public Involvement in Health Act 2007 the Secretary of State has taken powers to issue guidance on accounting practices. Guidance on Minimum Revenue Provision was issued under this section on 8 November 2007.

50. The Councils Treasury Management function has complied with all of the relevant statutory and regulatory requirements, which limit the levels of risk associated with its treasury management activities. In particular its adoption and implementation of both the Prudential Code and the code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable and its treasury practices demonstrate a low risk approach.

51. Officers of the Council are aware of the risks of passive management of the treasury portfolio and, with the support of Capita Asset Services, the Council's advisers, have proactively managed the debt and investments over the year.

Treasury Management Budget

52. There are three main elements within the Treasury Management Budget :-

(a) Long Term capital investments including Property Funds which earns interest, this comprises of the Council's revenue and capital balances, unused capital receipts, reserves and provisions.

(b) Cash flow interest earned – since becoming a unitary council in 1997, the authority has consistently had positive cash flow. Unlike long term capital investments it does not represent any particular sum but it is the consequence of many different influences such as receipts of grants, the relationship between debtors and creditors, cashing of cheques and payments to suppliers.

(c) Debt servicing costs – This is the principal and interest costs on the Council's long term debt to finance the capital programme.

Table 11 Changes to the Treasury Management Budget 2017/18

	£M	£M
Original Treasury Management Budget		**1.618**
Debt		
Add increased interest payable on debt	**0.106**	
Less further savings on MRP	**-0.133**	
Add additional annual premium on rescheduled debt	**0.002**	**-0.025**
Investments		
Less increased investment income including property funds		**-0.648**
Other Costs		
Add increased brokerage charges due to property funds		**0.073**
Outturn Treasury Management Budget 2017/18		**1.018**

53. The majority of the savings relate to the inclusion and purchase of Property Fund units in the investment portfolio, with the return reduced due to additional interest payments on debt and additional brokerage fees.

Conclusion

54. The Council's treasury management activity during 2017/18 has been carried out in accordance with Council Policy and within legal limits. Financing costs have been reduced during the year and a saving of £0.600M achieved from the original MTFP.

Outcome of Consultation

55. No formal consultation has been undertaken regarding this report, but it was examined by Audit Committee at their meeting on 26 July 2018

Additional Prudential Indicators not reported in the body of the report

		2016/17 Actual	2017/18 Approved Indicator	2017/18 Outturn
1	**Upper limits on fixed interest rates (*against maximum position*)**	**79%**	**100%**	**83%**
2	**Upper limits on variable interest rates (*against maximum position*)**	**21%**	**40%**	**17%**
3	**Maturity structure of fixed rate borrowing (*against maximum position*)**			
	Under 12 months	**5.5%**	**25%**	**17%**
	12 months to 2 years	**7.9%**	**40%**	**3%**
	2 years to 5 years	**3.7%**	**60%**	**10%**
	5 years to 10 years	**1.6%**	**80%**	**5%**
	10 years and above	**81.3%**	**100%**	**65%**
4	**Maximum Principal funds invested greater than 364 days**	**£0M**	**£30M**	**£30M**

APPENDIX 2

The Economy and Interest Rates

1. **UK.** The outcome of the EU referendum in June 2016 resulted in a gloomy outlook and economic forecasts from the Bank of England based around an expectation of a major slowdown in UK GDP growth, particularly during the second half of 2016, which was expected to push back the first increase in Bank Rate for at least three years. Consequently, the Bank responded in August 2016 by cutting Bank Rate by 0.25% to 0.25% and making available over £100bn of cheap financing to the banking sector up to February 2018. Both measures were intended to stimulate growth in the economy. This gloom was overdone as the UK economy turned in a G7 leading growth rate of 1.8% in 2016, (actually joint equal with Germany), and followed it up with another 1.8% in 2017, (although this was a comparatively weak result compared to the US and EZ).

2. 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; quarter 1 came in at +0.3% (+1.7% y/y) and quarter 2 was +0.3% (+1.5% y/y), which meant that growth in the first half of 2017 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 in quarter 3 to 0.5% before dipping slightly to 0.4% in quarter 4.

3. Consequently, market expectations during the autumn rose significantly that the MPC would be heading in the direction of imminently raising Bank Rate. The MPC meeting of 14 September provided a shock to the markets with a sharp increase in tone in the minutes where the MPC considerably hardened their wording in terms of needing to raise Bank Rate very soon. The 2 November MPC quarterly Inflation Report meeting duly delivered on this warning by withdrawing the 0.25% emergency rate cut which had been implemented in August 2016. Market debate then moved on as to whether this would be a one and done move for maybe a year or more by the MPC, or the first of a series of increases in Bank Rate over the next 2-3 years. The MPC minutes from that meeting were viewed as being dovish, i.e. there was now little pressure to raise rates by much over that time period. In particular, the GDP growth forecasts were pessimistically weak while there was little evidence of building pressure on wage increases despite remarkably low unemployment. The MPC forecast that CPI would peak at about 3.1% and chose to look through that breaching of its 2% target as this was a one off result of the devaluation of sterling caused by the result of the EU referendum. The inflation forecast showed that the MPC expected inflation to come down to near the 2% target over the two to three year time horizon. So this all seemed to add up to cooling expectations of much further action to raise Bank Rate over the next two years.

4. However, GDP growth in the second half of 2017 came in stronger than expected, while in the new year there was evidence that wage increases had started to rise. The 8 February MPC meeting minutes therefore revealed another sharp hardening in MPC warnings focusing on a reduction in spare capacity in the economy, weak increases in productivity, higher GDP growth forecasts and a shift of their time horizon to focus on the 18 – 24 month period for seeing inflation come down to 2%. (CPI inflation ended the year at 2.7% but was forecast to still be just over 2% within two years.) This resulted in a marked increase in expectations that there would be another Bank Rate increase in May 2018 and a bringing forward of the timing of subsequent increases in Bank Rate. This shift in market expectations resulted in investment rates from 3 – 12 months increasing sharply during the spring quarter.

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

6. As for equity markets, the FTSE 100 hit a new peak near to 7,800 in early January before there was a sharp selloff in a number of stages during the spring, replicating similar developments in US equity markets.

7. 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. However, sterling did suffer a sharp devaluation against most other currencies, although it has recovered about half of that fall since then. Brexit negotiations have been a focus of much attention and concern during the year but so far, there has been little significant hold up to making progress.

8. The manufacturing sector has been the bright spot in the economy, seeing stronger growth, particularly as a result of increased demand for exports. It has helped that growth in the EU, our main trading partner, has improved significantly over the last year. However, the manufacturing sector only accounts for around 11% of GDP so expansion in this sector has a much more muted effect on the average total GDP growth figure for the UK economy as a whole.

9. **EU.** Economic growth in the EU, (the UK's biggest trading partner), was lack lustre for several years after the financial crisis despite the ECB eventually cutting its main rate to -0.4% and embarking on a massive programme of quantitative easing to stimulate growth. However, growth eventually picked up in 2016 and subsequently gathered further momentum to produce an overall GDP figure for 2017 of 2.3%. Nevertheless, despite providing this massive monetary stimulus, the ECB is still struggling to get inflation up to its 2% target and in March, inflation was still only 1.4%. It is, therefore, unlikely to start an upswing in rates until possibly towards the end of 2019.

10. **USA.** Growth in the American economy was volatile in 2015 and 2016. 2017 followed that path again with quarter 1 at 1.2%, quarter 2 3.1%, quarter 3 3.2% and quarter 4 2.9%. The annual rate of GDP growth for 2017 was 2.3%, up from 1.6% in 2016. Unemployment in the US also fell to the lowest level for 17 years, reaching 4.1% in October to February, while wage inflation pressures, and inflationary pressures in general, have been building. The Fed has been the first major western central bank to start on an upswing in rates with six increases since the first one in December 2015 to lift the central rate to 1.50 – 1.75% in March 2018. There could be a further two or three increases in 2018 as the Fed faces a challenging situation with GDP growth trending upwards at a time when the recent Trump fiscal stimulus is likely to increase growth further, consequently increasing inflationary pressures in an economy which is already operating at near full capacity. In October 2017, the Fed also became the first major western central bank to make a start on unwinding quantitative easing by phasing in a gradual reduction in reinvesting maturing debt.

11. **Chinese economic growth** has been weakening over successive years, despite repeated rounds of central bank stimulus and medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems.

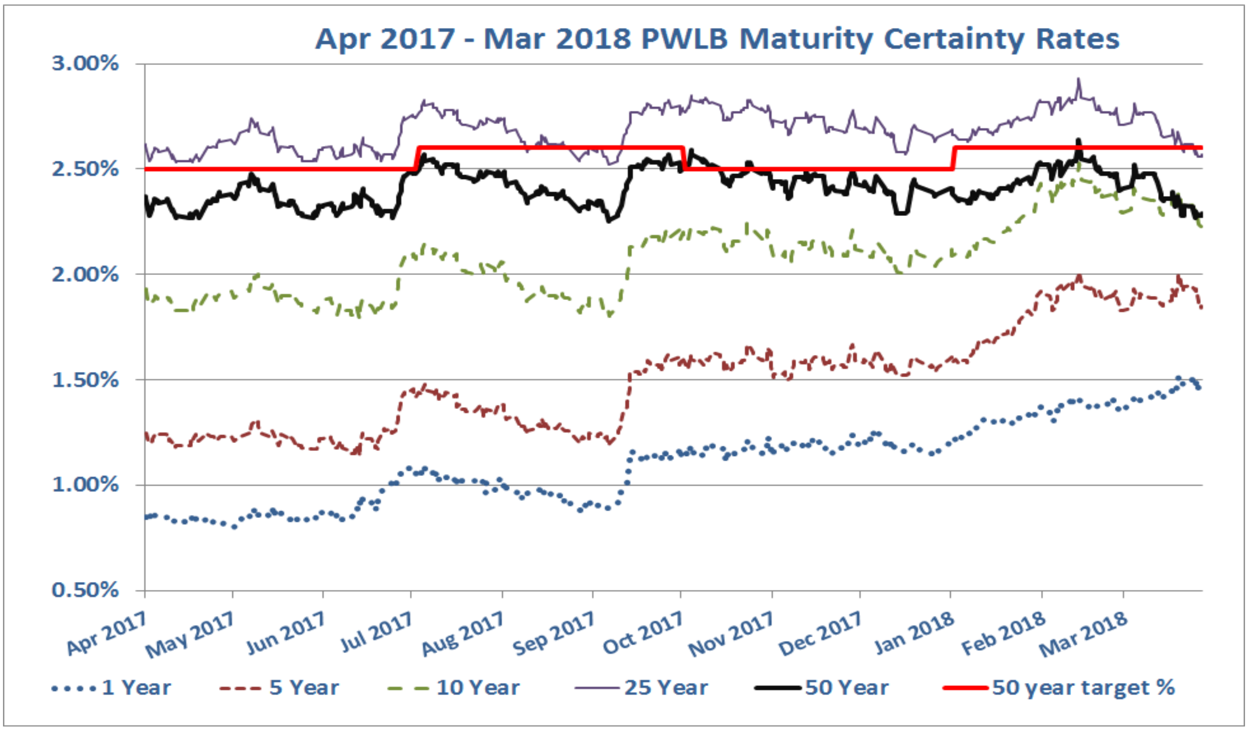
12. **Japan.** GDP growth has been improving to reach an annual figure of 2.1% in quarter 4 of 2017. However, it is still struggling to get inflation up to its target rate of 2% despite huge monetary and fiscal stimulus, although inflation has risen in 2018 to reach 1.5% in February. It is also making little progress on fundamental reform of the economy.

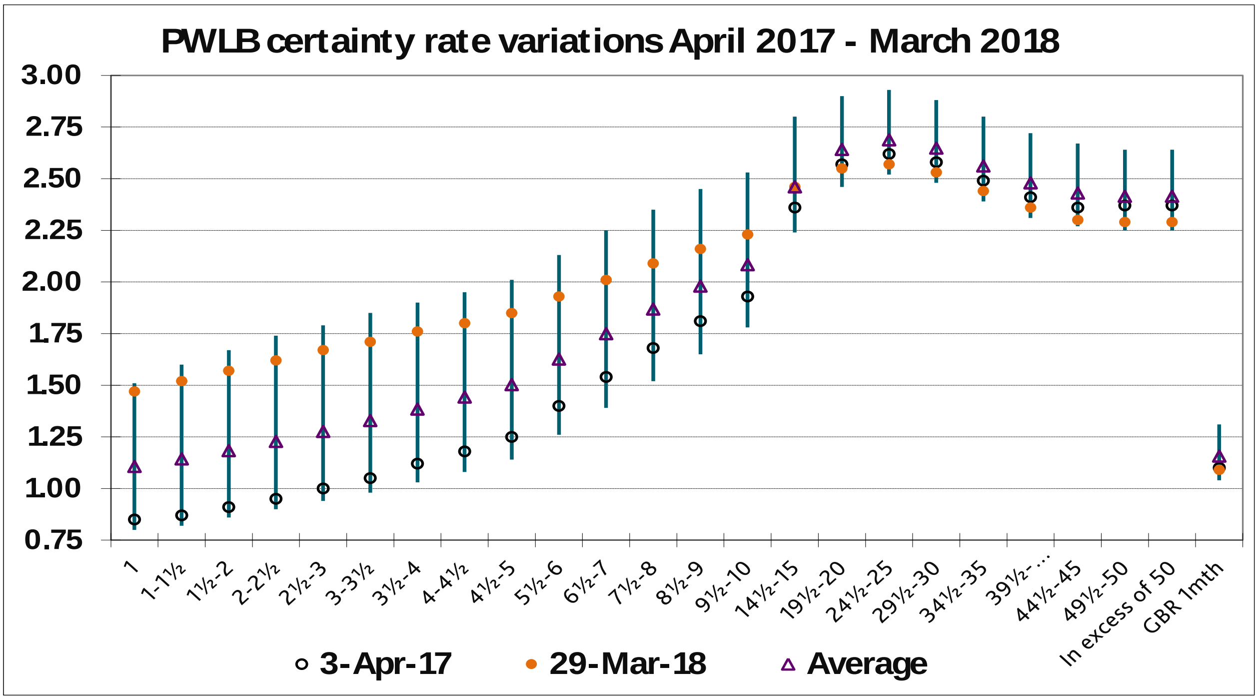
PWLB certainty maturity borrowing rates 2017/18

13. As depicted in the graph and tables below and in appendix 3, PWLB 25 and 50 year rates have been volatile during the year with little consistent trend. However, shorter rates were on a rising trend during the second half of the year and reached peaks in February / March.

14. 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.

15. The graphs and tables for PWLB rates show, for a selection of maturity periods, the average borrowing rates, the high and low points in rates, spreads and individual rates at the start and the end of the financial year.





	1	1-1.5	2.5-3	3.5-4	4.5-5	9.5-10	24.5-25	49.5-50	1 month variable
3/4/17	0.850%	0.870%	1.000%	1.120%	1.250%	1.930%	2.620%	2.370%	1.100%
29/3/18	1.470%	1.520%	1.670%	1.760%	1.850%	2.230%	2.570%	2.290%	1.090%
High	1.510%	1.600%	1.790%	1.900%	2.010%	2.530%	2.930%	2.640%	1.310%
Low	0.800%	0.820%	0.940%	1.030%	1.140%	1.780%	2.520%	2.250%	1.040%
Average	1.107%	1.143%	1.276%	1.384%	1.503%	2.083%	2.688%	2.415%	1.157%
Spread	0.710%	0.780%	0.850%	0.870%	0.870%	0.750%	0.410%	0.390%	0.270%
High date	21/03/2018	21/03/2018	21/03/2018	21/03/2018	15/02/2018	15/02/2018	15/02/2018	15/02/2018	21/03/2018
Low date	03/05/2017	03/05/2017	30/05/2017	15/06/2017	15/06/2017	15/06/2017	08/09/2017	08/09/2017	04/04/2017

	1 Year	5 Year	10 Year	25 Year	50 Year
1/4/17	0.85%	1.25%	1.93%	2.62%	2.37%
31/3/18	1.47%	1.85%	2.23%	2.57%	2.29%
Low	0.80%	1.14%	1.78%	2.52%	2.25%
Date	03/05/2017	15/06/2017	15/06/2017	08/09/2017	08/09/2017
High	1.51%	2.01%	2.53%	2.93%	2.64%
Date	21/03/2018	15/02/2018	15/02/2018	15/02/2018	15/02/2018
Average	1.11%	1.50%	2.08%	2.69%	2.41%

Money market investment rates 2017/18

	7 day	1 month	3 month	6 month	1 year
1/4/17	0.111	0.132	0.212	0.366	0.593
31/3/18	0.364	0.386	0.587	0.704	0.878
High	0.366	0.390	0.587	0.704	0.879
Low	0.099	0.122	0.140	0.273	0.461
Average	0.215	0.233	0.286	0.401	0.606
Spread	0.267	0.268	0.447	0.432	0.418
High date	27/2/18	22/3/18	29/3/18	29/3/18	28/3/18
Low date	4/7/17	10/8/17	7/8/17	7/9/17	6/9/17

Glossary of Terms

Capital Financing Requirement (CFR)	This is the Councils underlying need to borrow which can be traced back to the Councils Balance Sheet and the value of the Councils assets which have yet to be paid for.
Minimum Revenue Provision (MRP)	Monies set aside from the revenue budget to repay accumulated debt.
Call	Investments that can be returned without a period of notice
Counterparty	Institutions, Banks etc. that with make investments or take out loans with.
Specified Investments	Investments in Banks and Building Societies with a high credit rating for periods of less than 1 year
Non-Specified Investments	Investments in un rated Building Societies and any investments in Banks and Building Societies for more than 1 year.
Operational Liquidity	Working Cash flow
Authorised Limit	Maximum amount of borrowing that could be taken in total.
Operational Boundary	The expected amount of borrowing assumed in total.
PWLB	Public Works Loan Board. The Governments lending body to Local Authorities
Discount	Amount payable by the PWLB when loans are repaid if the current loan rate is less than the rate borne by the original debt
Yield Curve	Is a graph that shows the relationship between the interest rate paid and length of time to repayment of a loan.
Gilts	Government Borrowing Bonds
Spreads	The difference between the highest rate of interest and the lowest rate of interest earned/charged on any one particular maturity period i.e. 1 year, 2 year 5 year etc.
LIBID	London Interbank Bid Rate. The average rate at which a bank is willing to borrow from another bank.
LIBOR	London Interbank Offer Rate. The average rate at which a bank is willing to lend to another bank. LIBOR is always higher than the corresponding bid rate and the difference between the two rates is known as the spread.