Agenda Item No. 8

South Ayrshire Council

Report by Head of Finance and ICT
to Audit and Governance Panel
of 29 August 2018

Subject: Treasury Management Annual Report 2017/18

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1. Purpose

1.1 The purpose of this report is to present, in line with the requirements of the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management, the annual report of treasury management activities for 2017/18 (as attached at Appendix 1), and seek Members' consideration of its contents.

2. Recommendation

2.1 It is recommended that the Panel:

2.1.1 considers the Annual Treasury Management Report 2017/18, as attached at Appendix 1; and

2.1.2 remits the Annual Treasury Management Report to the next full Council meeting on 4 October 2018 for approval.

3. Background

3.1 The Council is required through regulations issued under the Local Government in Scotland Act 2003 to produce an annual treasury report reviewing treasury management activities and prudential and treasury indicators. 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).

3.2 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.

3.3 The Head of Finance and ICT also confirms that the Council has complied with the requirements under the Code, to give prior scrutiny of treasury management reporting to the Council's Audit and Governance Panel prior to submitting the report to full Council.

3.4/

3.4 Treasury management in this context is defined as:

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

4. Proposals

4.1 The Treasury Management Annual Report for 2017/18 is submitted to the Panel, as Audit Committee, in accordance with the requirements of the CIPFA Code of Practice on Treasury Management, for consideration and thereafter remit to the full Council meeting on 4 October 2018 for approval.

4.2 ***Executive Summary***

During 2017/18, the Council complied with its legislative and regulatory requirements. The key prudential indicators detailing the impact of capital expenditure activities during the year, with previous year comparators, are shown in Table 1 below.

Table 1 - **Actual Prudential and Treasury Indicators**

	2016/17 Actual £'000	***2017/18 Actual £'000***
Capital Expenditure	**67,280**	**40,174**
Total Capital Financing Requirement (including other long term liabilities)	266,993	293,950
PPP and Finance Lease	(59,869)	(82,044)
Underlying Borrowing Requirement	**207,124**	**211,906**
Gross External Debt	190,709	206,293
Under (Over) Borrowed	16,415	5,613
Cash/Investments	(49,086)	(57,334)
Net External Debt	**141,623**	**148,959**

4.3 The table above shows that the Council has as an under-borrowed position at 31 March 2018 of £5.613m. This means the Council has used some internal borrowing from cash/reserves to fund an element of its current capital expenditure requirements. It does not indicate that borrowing for the capital programme has not been under-taken, only that internal cash resource have been used as funding, opposed to external borrowing.

4.4 Although this is a prudent position in the current interest rate environment given the cost of external borrowing compared with cash investment rates, the Council's under-borrowed position is only 2.64% of its overall under-lying borrowing requirement and is therefore manageable within the current strategy. The strategy for 2018/19 is expected to maintain a marginal under-borrowed position whilst closely monitoring longer term PWLB and market rates in considering new borrowing.4.5 Other prudential and treasury indicators are included in Appendix 1 to this report. The Head of Finance and ICT also confirms that any borrowing was only undertaken for capital purpose and the statutory borrowing limit (the authorised limit) was not breached during 2017/18.

4.5 The financial year 2017/18 continued the challenging investment environment of previous years, namely low investment returns.

5. Legal and Procurement Implications

5.1 There are no legal implications arising from this report.

5.2 There are no procurement implications arising from this report.

6. Financial Implications

6.1 General Services

6.1.1 ***Capital Financing Costs*** - the Council originally budgeted £14.157m for financing costs and expenses on debt for 2017/18. This budget consisted of £7.802m in loan principal, £6.198m in interest and £0.157m in expenses.

During 2017/18, a pragmatic approach was taken when considering the borrowing requirements to fund capital expenditure. The borrowing strategy and the re-structuring of the loans pool debt during 2017/18 resulted in savings of £1.814m as under-noted in Table 2 below.

6.1.2 ***Interest on Revenue Balances Held*** – the Council originally budgeted to receive £0.140m (based on a return of 0.25%) in interest income to the General Fund in 2017/18. Interest rates for investment remained low, however with a bank rate rise in Nov 17 and the investment strategy out performing both the budget and benchmark this resulted in an enhanced return.

Investment income to the General Fund out-turned at £0.300m, a surplus of £0.160m. Interest was also received to the Council's Repairs and Renewals Fund and Insurance Fund to the value of £0.012m.

Table 2 – General Services - Capital Financing costs and Investment income 2017/18

	Budget £m	***Out-turn £m***	***Variance (fav/ adv) £m***
Principal	7.802	6.045	1.757
Interest	6.198	6.128	0.070
Expenses	0.157	0.170	(0.013)
	14.157	**12.343**	**1.814**
Investment Income	(0.140)	(0.300)	0.160
	14.017	**12.043**	**1.974**

6.2 **Housing Revenue Account (HRA)**

6.2.1 ***Capital Financing Costs*** - the HRA budgeted £4.726m for financing costs on debt for 2017/18. This consisted of £2.212m in loan principal, £2.452m in interest and £0.062m in expenses.

The borrowing strategy and debt re-structuring undertaken in 2017/18 resulted in an overall saving to the HRA of £1.075m as under-noted in Table 3 below.

6.2.2 ***Interest on HRA Revenue Balances Held*** – the HRA budgeted to receive investment income of £0.032m on its revenue balances in 2017/18 based on achieving an interest rate of 0.25%.

Similar to the General Fund the investment strategy was able to out-perform both budget and benchmark resulting in a return of £0.115m in investment income a surplus of £0.083m

Table 3 – HRA Capital Financing costs and Investment income 2017/18

	Budget £m	***Out-turn £m***	***Variance fav/(adv) £m***
Principal	2.212	1.193	1.019
Interest	2.452	2.391	0.061
Expenses	0.062	0.066	(0.004)
	4.726	**3.650**	**1.076**
Investment Income	(0.032)	(0.115)	0.083
	4.694	**3.535**	**1.159**

6.3 In total, net debt financing costs were under spent by £2.890m, and when added to an over achievement in investment income of £0.243m resulted in an overall surplus of £3.133m which was reflected in the Council and HRA financial position at 2017/18.

7. Human Resources Implications

7.1 Not applicable.

8. Risk

8.1 ***Risk Implications of Adopting the Recommendations***

8.1.1 There are no risks associated with adopting the recommendations.

8.2 ***Risk Implications of Rejecting the Recommendations***

8.2.1 If the recommendations are rejected, then the Council will be non-compliant with the requirements contained in 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).

9. Equalities

9.1 The proposals in this report have been assessed through the Equality Impact Assessment Scoping process. There are no significant potential positive or negative equality impacts of agreeing the recommendations and therefore an Equalities Impact Assessment is not required. A copy of the Equalities Scoping Assessment is attached as Appendix 2.

10. Sustainable Development Implications

10.1 ***Considering Strategic Environmental Assessment (SEA)*** - This report does not propose or seek approval for a plan, policy, programme or strategy or document otherwise described which could be considered to constitute a plan, programme, policy or strategy.

11. Options Appraisal

11.1 An options appraisal has not been carried out in relation to the subject matter of this report.

12. Link to Council Plan

12.1 The matters referred to in this report contribute to the Council strategic objective of 'Effective Leadership that Promotes Fairness' and within that to the outcome 'Ensure the Council is structured to make the best use of resources'.

13. Results of Consultation

13.1 There has been no public consultation on the contents of this report.

13.2 Consultation has taken place with Councillor Peter Henderson, Portfolio Holder for Resources and Performance, and the contents of this report reflect any feedback provided.

Background Papers **CIPFA Code of Practice for Treasury Management in Local Authorities**

Report to South Ayrshire Council of 2 March 2017 – Treasury Management and Investment Strategy 2017/18

Report to South Ayrshire Council of 14 December 2017 – Treasury Management Mid-Year Report – 2017/18

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Appendix 1

South Ayrshire Council

Treasury Management Annual Report 2017/18

Introduction

In accordance with the requirements of the CIPFA Code of Practice on Treasury Management in the Public Services, this report covers the following:

- Section 1 - The Council's Capital Expenditure and Financing 2017/18;
- Section 2 – The Council's overall borrowing need;
- Section 3 – Treasury Position as at 31 March 2018;
- Section 4 – The Strategy for 2017/18;
- Section 5 – The Economy and Interest Rates
- Section 6 – Borrowing Rates in 2017/18;
- Section 7 – Borrowing Out-turn 2017/18; and
- Section 8 – Investment Rates and Out-turn 2017/18.
- Section 9 – Other Issues

Section 1 The Council's Capital Expenditure and Financing 2017/18

1.1 The Council undertakes capital expenditure on long-term assets. These activities may either be:

- financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc), which have no resultant impact on the Council's borrowing need; or

- if insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing requirement.

1.2 The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual expenditure, how this was financed and the resulting borrowing requirement.

Table 1

Item	*2016/17 Actual £'000*	*2017/18 Estimate per Strategy*	*2017/18 Actual*
General Fund capital expenditure	54,195	31,108	25,289
HRA capital expenditure	13,085	18,675	14,885
Total	**67,280**	**49,783**	**40,174**
Resourced by:			
Government grant and other contributions	(15,445)	(12,231)	(13,571)
Other funding identified	(13,188)	(15,062)	(14,583)
Borrowing :	**38,647**	**22,490**	**12,020**

Section 2 The Council's Overall Borrowing Need

2.1 The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's indebtedness. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represents the 2017/18 unfinanced capital expenditure (Table 1), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

2.2 Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service manages the Council's cash position to ensure that sufficient cash is available to meet not only the capital plans but also to manage the daily cash flow requirements of funding its revenue commitments of payroll, suppliers, benefits etc.

2.3 This borrowing for capital expenditure may be sourced through external bodies such as the Government, through the Public Works Loan Board [PWLB] or the money markets), or utilising temporary cash resources within the Council (internal borrowing).

2.4 ***Reducing the CFR*** – the Council's underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the scheduled debt amortisation as a loan repayment, to reduce the CFR. This is effectively a repayment of the borrowing need and differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

The total CFR can also be reduced by:

- the application of additional capital financing resources (such as unapplied capital receipts); or

- by charging more than the scheduled debt amortisation for loans repayment.

2.5 The Council's CFR for the year is shown below, and represents a key prudential indicator. It includes Private Finance Initiatives or Public/ Private Partnerships (PFI/ PPPs) and leasing schemes on the balance sheet, which increase the Council's CFR, however no borrowing is actually required against these schemes as a borrowing facility is included in these contracts.

The undernoted table shows the Council's underlying borrowing requirement, inclusive of PPP and Finance lease arrangements, as at 31 March 2018.

Table 2/

Table 2

Capital Financing Requirement	31 Mar 2017 £'000	31 Mar 2018 £'000
Opening Balance	**239,702**	**266,993**
Add unfinanced capital expenditure	38,647	12,020
Add new Other Long Term Liability obligations (PPP)	-	24,877
Less loans fund repayment	(9,106)	(7,238)
Less PPP/ finance lease repayment	(2,250)	(2,702)
Closing Balance	**266,993**	**293,950**

The borrowing activity is constrained by prudential indicators for gross borrowing, CFR, and by the authorised limit. The increasing CFR position reflects the Council's capital programme expenditure in 2017/18 and the resulting borrowing requirements to fund this investment.

2.6 ***Gross Borrowing and the CFR*** - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2017/18) plus the estimates of any additional capital financing requirement for the current (2018/19) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure.

This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs. The table below highlights the Council's gross borrowing position against the CFR.

Table 3

Item	***31 March 2017 £'000***	***31 March 2018 £'000***
Capital Financing Requirement (CFR)	266,993	293,950
Gross External Borrowing Position (including PPP and finance Lease)	250,578	288,337
Net Under/ (Over) Borrowed Position	**16,415**	**5,613**

The table above shows the CFR as an under-borrowed position at 31 March 2018 of £5.613m. This means the Council has used some internal borrowing from cash/ reserves to fund an element of its current capital expenditure requirements.

This is a prudent position in the current interest rate environment given the cost of external borrowing compared with cash investment rates. The current strategy for 2018/19 is expected to maintain this under-borrowed position whilst closely monitoring longer term PWLB and market rates and consideration of potentially re-financing some of the temporary loan debt with longer term borrowing.

2.7/

2.7 ***Borrowing Prudential Indicators***

- **The Authorised Limit – Table 4 -** the authorised limit is the maximum borrowing limit, beyond which the Council does not have the power to borrow. Table 4 below demonstrates that during 2017/18 the Council has maintained gross borrowing within its authorised limit.

- **The Operational Boundary – Table 4** – the operational boundary is the expected borrowing position of the Council during the year with headroom for daily cash flow variations. Periods where the actual position is either below or over the boundary is acceptable subject to the authorised limit not being breached.

  This was the case in 2017/18 due to the addition of other long term liabilities in relation to PPP projects. The operational boundary position will be reviewed and updated in 2018/19 treasury reporting.

- **Actual Financing Costs as a Proportion of Net Revenue Stream** – **Table 5 -** this indicator identifies the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream of the Council.

Table 4

Item	***2016/17 £'000***	***2017/18 £'000***
Authorised Borrowing Limit External Debt	**307,000**	**307,000**
Borrowing	190,709	206,293
Other Long Term Liabilities	59,869	82,045
Total	**250,578**	**288,338**
Operational Boundary External Debt	**257,000**	**265,000**
Borrowing	190,709	206,293
Other Long Term Liabilities	59,869	82,045
Total	**250,578**	**288,338**

Table 5

Ratio of Financing Costs to Net Revenue Stream	***Actual 2016/17***	***Actual 2017/18***
General Services	5.78%	6.03%
HRA	15.54%	10.96%
Total	**6.86%**	**6.72%**

Section 3 Treasury Position

3.1 The Council's debt and investment position is administered by the treasury management team in order to ensure adequate liquidity for revenue and capital activities, security for investments, and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through member reporting, and through officer activity detailed in the Council's Treasury Management Practices.

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

Table 6

	Borrowing position as at 31 March 2017		***Borrowing position as at 31 March 2018***		***Change in year***
	£'000	***Average interest rate %***	***£'000***	***Average interest rate %***	***£'000***
Long Term Borrowing					
Public Works Loans Board	114,504	5.35	110,088	4.99	(4,416)
Market – Fixed	-	-	5,000	0.95	5,000
Lender Option Borrower Option (LOBO) (Option Loans)	41,205	4.52	41,205	4.52	-
Total Long Term Borrowing	**155,708**	**5.13**	**156,293**	**4.868**	**584**
Short Term Borrowing	35,000	0.37	50,000	0.61	15,000
Total External Borrowing	**190,709**	**4.25**	**206,293***	**3.84**	**15,584**
CFR (underlying borrowing need)	207,124		211,906		4,732
Over (Under) Borrowing	**(16,415)**		**(5,613)**		**10,802**
Investments	**(48,086)**	**0.53**	**(57,334)**	**0.61**	**(9,248)**

* The carrying amount of loans on the Council's balance sheet as at 31 March 2018 is £207.161m. The difference between this figure and the external borrowing shown in Table 6 as at 31 March 2018 of £206.293m above is £0.868m of equivalent interest rate accounting adjustments required by the Code of Practice on local authority accounting.

3.2 Table 7 below details the profile of the Council's loan maturity periods as at 31 March 2018.

Table 7/

Table 7

Maturity analysis of Debt Outstanding at 31 March 2018	***PWLB £'000***	***Market £'000***	***LOBO £'000***	***Temp Borrowing***	***Total £'000***
Maturing within 1 year	2,636	-	-	50,000	52,636
Maturing 1 to 2 years	2,489	5,000	-	-	7,489
Maturing 2 to 5 years	3,778	-	-	-	3,778
Maturing 5 to 10 years	9,204	-	3,005	-	12,209
Maturing 10 to 20 years	27,808	-	3,000	-	30,808
Maturing 20 to 30 years	8,505	-	5,500	-	14,005
Maturing 30 to 40 years	54,367	-	10,000	-	64,367
Maturing 40 to 50 years	1,300	-	9,700	-	11,000
Maturing > 50 years	-	5,000	5,000	-	10,000
Total	***110,088***	***10,000***	***36,205***	***50,000***	***206,293***

3.3 ***Loans Fund***

3.3.1 From 1 April 2016 further changes were required in reporting borrowing and loans fund transactions by Statutory Instrument 2016 No 123 and Circular 2016-7 from the Scottish Government as follows:

- Section 56 of the Local Government (Scotland) Act 1973 permits a Local Authority to discharge their functions by committee. An exception is borrowing money which is to be discharged by the authority. The reporting requirements are set out in the Annual Strategy or Annual Report and hence will be subject to approval by the local authority (full Council).

- A Local authority is required to document it's policy on the prudent repayment of loans fund advances. (this is set out in the Annual Treasury and Investment Strategy which is submitted to full Council)

- The decisions taken each year on new loans fund advances – the period and amount of each repayment, creates a liability to repay those advances from future year budgets. A local authority is required to report on the commitment to repay loans fund advances. The report should identify the opening balance of the loans fund at 1 April, the value of new advances, the value of repayments, and the closing balance at 31 March.

- Where a local authority has a Housing Revenue Account, the HRA should be reported separately from the General Fund. The reporting on the commitment to repay loans fund advances is for repayments only and does not include any interest costs.

3.3.2 The Loans Fund balances are set out in Table 8 (a) and Table 8 (b) below.

Table 8 (a) – Loans Fund Advances to General Fund

Loans Fund	***31 March 2017 (£'000)***	***31 March 2018 (£'000)***
Opening Balance	117,692	147,011
Add advances	36,298	11,718
Less repayments	(6,979)	(6,045)
Closing Balance	**147,011**	**152,684**

Table 8 (b) – Loans Funs Advances to HRA

Loans Fund	***31 March 2017 (£'000)***	***31 March 2018 (£'000)***
Opening Balance	57,542	57,725
Add advances	2,350	302
Less repayments	(2,167)	(1,193)
Closing Balance	**57,725**	**56,834**

3.4 The Council has both fixed and variable rate borrowing and investment. The prudential indicator measures exposure of fixed and variable interest rates as a percentage of net debt. Table 9 below measures the Council's exposure to fixed and variable interest rates.

Table 9

Exposure to Fixed and Variable Interest Rates	***31 March 2017***	***31 March 2018***
Fixed Interest Rate Exposure as % of net debt	80.59%	76.45%
Variable Interest Rate Exposure as % of net debt	19.41%	23.55%
Effective ranges within which fixed interest exposures will be managed	75% to 100%	75% to 100%
Effective ranges within which variable interest exposures will be managed	0% to 25%	0% to 25%
Principal sums invested > 364 days	-	-

Section 4 Strategy for 2017/18

4.1 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 Qtr2 2019 and then only increase once more before March 2020.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.

4.2 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.

4.3 In this scenario, the treasury strategy was to focus in year borrowing in the short-term markets, taking advantage of cheap funding available, particularly in the inter local authority markets.

4.4 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.

Section 5 Economy and Interest Rates

5.1 ***UK*** -

5.1.1 The outcome of the EU referendum in June 2016 resulted in a gloomy outlook, and economic forecasts from the Bank of England were 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.

5.1.2 Consequently, the Bank of England 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 with both measures expected to provide a boost to 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 Eurozone).

5.1.3 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.

5.1.4 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; Qtr1 came in at +0.3% (+1.7% y/y) and Qtr2 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.

5.1.5 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 Qtr3 to 0.5% before dipping slightly to 0.4% in Qtr4.

5.1.6 Consequently, market expectations during the autumn rose significantly that the Monetary Policy Committee (MPC) would be heading in the direction of imminently raising Bank Rate. The 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.

5.1.7 The 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 off 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 and there was little evidence of building pressure on wage increases despite remarkably low unemployment.

5.1.8 The MPC forecast that Consumer Price Inflation (CPI) would peak at about 3.1% and chose to look through the 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.

5.1.9 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 Federal Reserve (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.

5.1.10 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.

5.1.11 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.

5.1.12 Brexit negotiations continued to be a focus of much attention and concern throughout the year.

5.1.13 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.

5.2 ***EU*** -

5.2.1 Economic growth in the EU, (the UK's biggest trading partner), was lack lustre for several years after the financial crisis despite the European Central Bank (ECB) eventually cutting its main rate to -0.4% and embarking on a massive programme of quantitative easing to stimulate growth.

5.2.2 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%.

5.2.3 It is, therefore, unlikely to start an upswing in rates until possibly towards the end of 2019.

5.3 ***USA*** –

5.3.1 Growth in the American economy was volatile in both 2015 and 2016, and 2017 followed that path again with Qtr1 at 1.2%, Qtr2 3.1%, Qtr3 3.2% and Qtr4 2.9%.

5.3.2 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.

5.4 ***China*** - economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus. 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.

5.5 ***Japan*** - GDP growth has been improving to reach an annual figure of 2.1% in Qtr4 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.

Section 6 Borrowing Rates in 2017/18

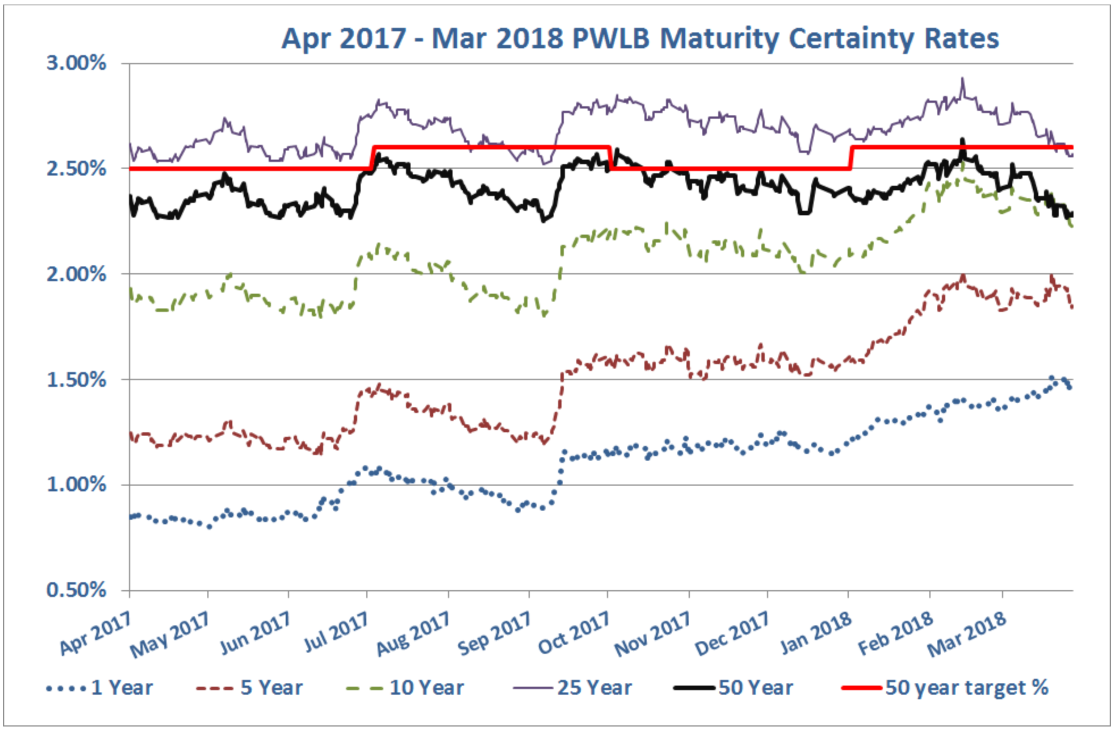
6.1 *PWLB Borrowing Rates*

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

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

The graph of PWLB rates below (Fig 1) 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.

Fig 1



Section 7 Borrowing Out-turn for 2017/18

7.1 During 2017/18 the Council funded much of the capital borrowing requirement in the short term market, increasing temporary borrowing to £50.000m, at March 2018. This strategy has decreased the under-borrowed position to £5.6m whilst taking advantage of low short term interest rates.

7.2 During 2018/19 focus will be on monitoring longer term rates and looking at the potential of moving some shorter term debt to longer term both in re-financing and new borrowing.

7.3 During 2017/18 the actual borrowing and repayments of external debt transacted are shown in Table 10 below. This shows the focus on temporary borrowing, a prudent position in current interest rate environment, and a key factor in reducing the external under-borrowed position going forward.

Table 10/

Table 10

Loan Type	***Borrowed 2017/18 £'000***	***Repaid 2017/18 £'000***	***Net £'000***
PWLB	0	(4,416)	(4,416)
Market Loans	5,000	0	5,000
Temporary borrowing	103,000	(88,000)	15,000
	108,000	**(92,416)**	**15,584**

7.4 ***Debt Re-scheduling*** – no external debt was re-scheduled during 2017/18 as the average differential of 1% between PWLB new borrowing rates and premature redemption rates made early repayment of loans expensive and unviable due to the premiums that would be payable.

Section 8 Investment Rates, Out-turn and Policy in 2017/18

8.1 Investment rates for 3 months and longer have been on a rising trend during the second half of the year in the expectation of Bank Rate increasing from its floor of 0.25%.

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.

Figs 2 and 3 below shows the bank rate and average of short term rates generally available in the market for investment period up to 1 year.

Fig 2

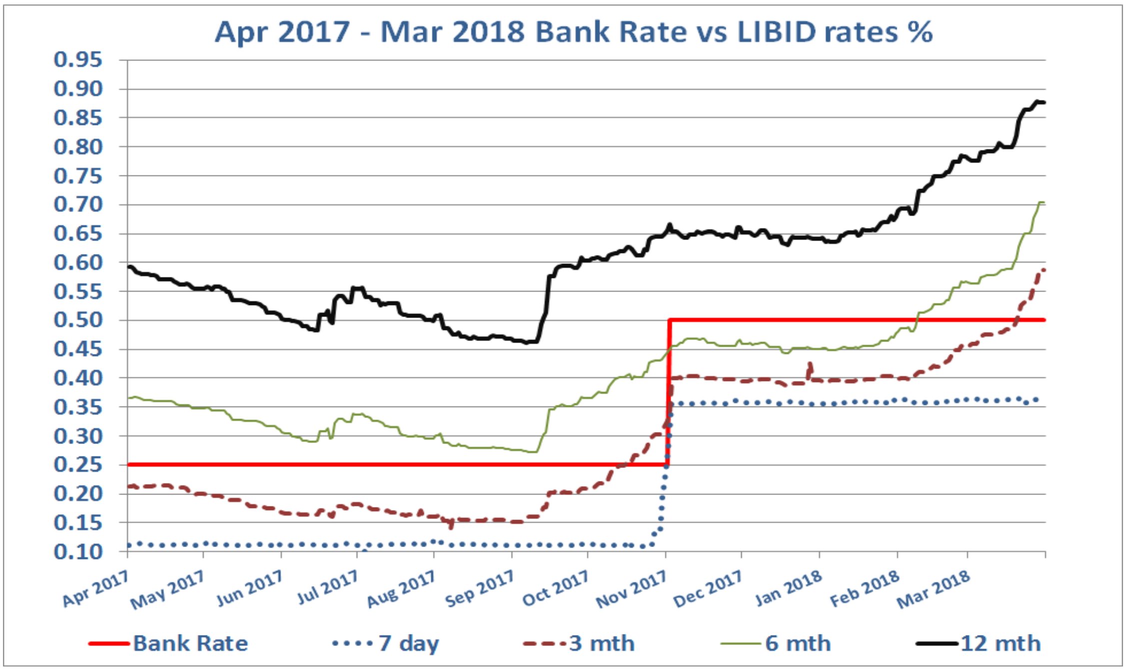


Fig 3 - Money Market Investment Rates 2017/18

	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

8.2 ***Investment Out-turn*** – the Council maintained an average balance of £54.2m of internally managed investment funds. The internally managed funds earned an average rate of return of 0.55%.

The comparable performance indicator is the average 3-Month LIBID rate which was 0.23%.

Table 11

	Average Value of Investments Held	***Rate of Return***	***Benchmark Return****
Investments	£54.294m	0.55%	0.23%

**The benchmark return used is the 3 month London Inter-bank bid rate (LIBID) of 0.23%. This represents the average rate that would be realised if deposits were placed on the inter-bank money market for continuing periods of 3 months throughout 2017/18*

8.3 ***Investment Policy*** – the Council's investment policy is governed by Scottish Government investment regulations which are included as part of the Annual Investment strategy approved by the Council on 2 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 met with the approved strategy, and the Council had no liquidity difficulties.

8.4/

8.4 ***Current Council Investments held at 31 March 2018***

Table 12

Class	Type	Start Date	Maturity date	Counterparty	Profile	Rate	Principal £000
Deposit	Fixed	31/10/17	30/10/18	Lancashire County Council	Maturity	0.55%	5,000
Deposit	Fixed	26/02/18	05/04/18	Suffolk County Council	Maturity	0.47%	5,000
Fixed total							**10,000**
Deposit	95 Day	24/09/15	-	Santander UK Plc	Variable	0.60%	5,000
Deposit	175 Day	10/11/15	-	Bank of Scotland (Treasury)	Variable	0.75%	25,000
Deposit	Call	10/05/16	-	Bank of Scotland (Corporate)	Variable	0.45%	9,600
MMF	Call	01/12/17	-	Federated Class3 Prime Fund	Variable	0.44%	7,500
Call Total							**47,100**
Overall Total						**0.61%**	**57,100**

Section 9 Other Issues

9.1 ***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.

Future reports to members will reflect any new requirements or implications as a result of these updated codes.

9.2 ***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. The introduction of MiFID II has had minimal impact on borrowing and lending activity; however the Council did require the completion of a range of form filling to comply with the regulation and its relationship with various counterparties and investment instruments used. This work is now complete and has resulted in the Council electing to opt up to a professional counterparty client as opposed to previous retail client as deemed by the directive.

Appendix 2

South Ayrshire Council **Equality Impact Assessment Scoping**

1. Proposal details

Proposal Title	Lead Officer
Treasury Management Annual Report 2017/18	**Tim Baulk**

2. Which communities, groups of people, employees or thematic groups do you think will be, or potentially could be, impacted upon by the implementation of this proposal? Please indicate whether these would be positive or negative impacts

Community, Groups of People or Themes	Negative Impacts	Positive impacts
The whole community of South Ayrshire	-	-
People from different racial groups, ethnic or national origin.	-	-
Women and/ or men (boys and girls)	-	-
People with disabilities	-	-
People from particular age groups for example Older people, children and young people	-	-
Lesbian, gay, bisexual and heterosexual people	-	-
People who are proposing to undergo, are undergoing or have undergone a process to change sex	-	-
Pregnant women and new mothers	-	-
People who are married or in a civil partnership	-	-
People who share a particular religion or belief	-	-
Thematic Groups: Health, Human Rights, Rurality and Deprivation	-	-

3. Do you have evidence or reason to believe that the proposal will support the Council to:

General Duty and other Equality Themes	Level of Negative and/ or Positive Impact (high, medium or low)
Eliminate discrimination and harassment faced by particular communities or groups	Low impact
Promote equality of opportunity between particular communities or groups	Low impact
Foster good relations between particular communities or groups	Low impact
Promote positive attitudes towards different communities or groups	Low impact
Increase participation of particular communities or groups in public life	Low impact
Improve the health and wellbeing of particular communities or groups	Low impact
Promote the human rights of particular communities or groups	Low impact
Tackle deprivation faced by particular communities or groups	Low impact

4. Summary Assessment

Is a full Equality Impact Assessment (EQIA) required? (A full EQIA must be carried out on all high and medium impact proposals**)**	**Yes** ☐ **No** x
Rationale for decision: **This report presents to the Panel the annual report of treasury management activities for 2015/16. Their decision on this has no specific equality implications.**	
Signed : **Tim Baulk** Head of Service	
Date: **19 July 2018**	Copy to equalities@south-ayrshire.gov.uk