Agenda Item No. 8

Audit Committee – 18 June 2018

Treasury Management Annual Report 2017/18

1. Summary of report

1.1 This report sets out Walsall council's treasury management annual report for 2017/18 as required by the CIPFA Code of Practice (Appendix A).

2. Recommendations

2.1. Audit Committee are asked to endorse the treasury management annual report for 2017/18 and recommend it to Council for approval the (Appendix A).

3. Background information

3.1 <u>Treasury Management Annual Report</u>

The council is required through regulations issued under the Local Government Act 2003 to produce an annual treasury report reviewing treasury management activities and prudential and treasury indicator performance.

The Treasury Management annual report at Appendix A provides Audit Committee with these details, and 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 <u>Highlights of TM Annual report</u>

The following key points of interest have been extracted from the report:

- The annual report meets the requirement of both the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities.

- Capital expenditure was £75.498m of which £18.304m was funded from approved borrowing (Table 2, Appendix A).

- The council made a repayment of £10m of long term debt. The council's average rate on its borrowing was reduced from 3.99% to 3.42%.

- The banking environment has continued to be one of the low interest returns with some improved confidence in counter party risk. Expected increases in interest rates did not materialise, other than the reversal of the emergency rate reduction that was applied following the Brexit vote during 2016.

- Despite this situation the authority has continued to identify appropriate new areas of investment opportunity that has led to a significant impact on average investment performance which increased from to 0.89% in 2016/17 to 1.32% in 2017/18.

3.3 The report is presented to Audit Committee with a recommendation for referral to Council for approval.

4. Risk Management

4.1 Treasury management activity takes place within a robust risk management environment which enables the council to effectively maximise investment income and minimise interest payments without undue or inappropriate exposure to financial risk. Treasury management practices (TMP) approved by Council provide the governance framework specifically TMP 1 which details the risk management arrangements in place.

5. Financial Implications

5.1 Treasury management activity forms part of the council's financial framework and supports delivery of the medium term financial strategy and Corporate Plan.

6. Legal Implications

6.1 The Council is required to have regard to the Prudential Code under the duties outlined by the Local Government Act 2003. One requirement of the Prudential Code is that the Council should comply with the CIPFA Code of Practice for Treasury Management. The Council complies fully.

7. Property implications

7.1 None directly relating to this report.

8. Health and wellbeing implications

8.1 None directly relating to this report.

9. Staffing implications

9.1 None directly relating to this report.

10. Equality Implications

10.1 None directly relating to this report.

11. Consultation

11.1 The report has been approved by the finance Treasury Management Panel, an internal governance arrangement comprising the Chief Finance Officer, Head of Finance and Senior Finance Manager.

Background Papers

- Various financial working papers
- Annual Review of Treasury Management Policies and mid-year position statement 2017/18– Audit Committee 20 November 2017
- Corporate budget plan and treasury management and investment strategy 2017/18 – Council 23 February 2017

V Buckley

Vicky Buckley – Head of Finance
8 June 2018

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Appendix A

Annual Treasury Management Report 2017/18

Walsall Council
June 2018

Annual Treasury Management Report 2017/18

Purpose

This council is required through regulations issued under the Local Government Act 2003 to produce an annual treasury report reviewing treasury management activities and prudential and treasury indicator performance. This document therefore reports this position for the 2017/18 financial year. 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 following reports were produced:

- an annual treasury strategy in advance of the year (Council 23/02/2017)
- a mid-year (minimum) treasury update report (Audit Committee 20/11/2017)
- an annual review of treasury management policies (Audit Committee 20/11/2017)
- an annual report following the year describing the activity compared to the strategy (this report to Audit Committee)

In addition, this council's treasury management panel has received regular treasury management update reports.

The regulatory environment places an onus on members for the review and scrutiny of treasury management policy and activities. This report is 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 also confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Audit Committee before they were reported to the full Council. In order to support members' scrutiny role member training on treasury management issues has been available to all members via the e-Learning platform throughout 2017/18.

Summary

During 2017/18, the council complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

Table 1 Actual prudential and treasury indicators	**2016/17 Actual £m**	**2017/18 Original £m**	**2017/18 Revised £m**	**2017/18 Actual £m**
Capital expenditure	80.847	52.554	103.650	75.498
Capital Financing Requirement:				
Including PFI and finance leases	335.150	344.171	As Original	351.593
Excluding PFI and finance leases	324.130	335.935	As Original	343.537
External Borrowing	266.890	319.318	As Original	319.318
Investments	152.230	148.894	As Original	148.894
Net borrowing	114.660	170.424	As Original	170.424

The capital programme was updated (revised column) during the year from that originally approved by Council on 23rd February 2017 (original column) for approved capital carry forwards and re-profiling of spend from 2016/17, additional grants received during the year, and the decision to purchase an investment property.

Other prudential and treasury indicators are to be found in the main body of this report. The Executive Director of Resources & Transformation (CFO) confirms that borrowing was only undertaken for capital purposes or to support required in year cash-flow requirements.

The challenging environment of low investment returns and uncertainty of counterparty risk has continued in 2017/18.

1. Introduction and background

To set the context of the treasury management environment it is first necessary to provide a review of the economy and interest rates.

In 2017/18 the challenging investment environment of previous years' continued, namely low investment returns, although levels of counterparty risk has continued to subside. The interest rate forecast at the start of the year was that the low interest rate environment would continue throughout 2017/18 and thus the target for investment return was maintained in line with previous years. An economic summary is given at the beginning of the borrowing and investment sections.

2. The Council's Capital Expenditure and Financing 2017/18

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 has 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 need.

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed. The amount to be funded from borrowing in 2017/18 was £18.304m. It shows a reduction in capital expenditure funded from grants mainly due to Growth Fund Projects, for which Walsall is the accountable body for all the Black Country Districts.

Table 2	2016/17 Actual £m	2017/18 Original £m	2017/18 Actual £m
Total capital expenditure	**80.847**	**52.554**	**75.498**
Resourced by:			
• Capital receipts	2.016	1.500	2.226
• Capital grants	64.762	36.667	52.034
• Capital Reserves and Revenue	3.118	2.778	2.934
• Approved Borrowing	10.951	11.609	18.304
	80.847	**52.554**	**75.498**

3. The Council's Overall Borrowing Need

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 debt position. The CFR results from the capital activity of the council and which resources have been used to pay for the capital spend. It represents the 2017/18 capital expenditure funded by borrowing (see table 2), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

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 organises the council's cash position to ensure sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from 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.

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 minimum revenue provision (MRP) to reduce the CFR. This 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 be reduced by:

- the application of additional capital financing resources (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a voluntary revenue provision (VRP).

In 2014/15 the MRP policy was reviewed, updated and approved by Council. Following a further review in 2015/16 Council on 26th February 2016 amended the implementation date of these changes from 1st April 2014 to 1st April 2008. The effect of this is a smoothing of the MRP charge. Rather than having a high MRP charge in initial years that reduces over time, the council will now pay a charge that is more consistent throughout a shorter time period. This will result in a lower MRP charge up to 2035/36 and then a higher MRP charge from 2036/37 to 2064/65. Overall the initial lower MRP charge is offset by the later higher MRP charge, although this increase will be lower in real terms because money loses value over time. The policy change supported the strategy of maintaining the level of current capital financing costs as a proportion of council tax revenue. A further outcome of the review of the MRP policy was a restatement of the Capital Financing Requirement (CFR) as at 31st March 2015. This was due to the review also highlighting the opportunity to apply consistently accounting practices from 2008 to 2015.

The council's CFR for the year 2017/18 is shown below in Table 3, and represents a key prudential indicator (PrI4). It includes Private Finance Initiative (PFI) and leasing schemes from the balance sheet which increase the council's borrowing need – although no borrowing is normally required against these schemes as a borrowing facility is included in the contract (if applicable). It shows that in 2017/18 the council's CFR has increased by £16.443m from £335.150m to £351.593m.

Table 3 **CFR (£m)**	**31 March 2017 Actual £m**	**31 March 2018 Actual £m**
Opening balance	**328.019**	**335.150**
Add capital expenditure funded from approved borrowing (as above)	10.951	18.304
Add adjustment to CFR	0.000	0.148
Less MRP	(3.820)	(2.009)
Closing balance	**335.150**	**351.593**

The borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit.

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term the council's external borrowing, net of investments, must only be for a capital purpose, or to fund expected in year cash-flow requirements. This essentially means that the council is not borrowing to support revenue expenditure. Net borrowing should not therefore, except in the short term, have exceeded the CFR. Table 4 below highlights the council's net borrowing position (£170.424m) against the CFR excluding PFIs and Finance leases (£343.537m) because the debt liability for these are not in the net borrowing position of the council. The council has complied with this prudential indicator.

Table 4	**31 March 2017 Actual £m**	**31 March 2018 Actual £m**
Gross Borrowing	**266.890**	**319.318**
Net borrowing position	**112.660**	**170.424**
CFR – excluding PFIs and Finance Leases	**324.130**	**343.537**
Long term Assets	**565.537**	**599.491**
Net Borrowing % of Long term Assets	**20%**	**28%**

Another measure of prudency is the proportion of net to fixed assets. Table 4 shows that the net borrowing position of the council as at 31/03/18 is £170.424m which represents 28% of the value of the council's long term assets which are valued on the council's balance sheet at that date (by comparison, the average position for our statistical neighbours was 28% at 31/03/17 – this data is not currently available for 31st March 2018).

Other key Prudential Indicators are shown in Table 5 below:

Table 5 Prudential and Borrowing Limits	2016/17 £m	2017/18 £m
1. Authorised limit	**360.965**	**362.390**
2. Maximum gross borrowing in year	**266.890**	**329.211**
3. Operational boundary	**328.150**	**329.445**
4. Average gross borrowing	**249.840**	**293.104**
5. Financing costs as proportion of net revenue stream	**5.50%**	**8.75%**

1. **The authorised limit** - the authorised limit is the "affordable borrowing limit" set by the council as required by section 3 of the Local Government Act 2003. The council does not have the power to borrow above this level without the prior approval of full Council. Table 5 demonstrates that during 2017/18 the council's maximum gross borrowing was within its authorised limit.

2. **Maximum Gross borrowing** – is the peak level of borrowing in year.

3. **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. In 2017/18 the council's average borrowing position was less than the operational boundary.

4. **Average Gross Borrowing** – is an estimate of the borrowing level in the year see Table 7 for analysis of Borrowing.

5. **Actual 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. Net revenue stream is defined as Net Council Tax Requirement + Standard Spending Assessment (previously Formula Grant).

4. Prudential Indicators

The following tables show performance against statutorily required prudential and local indicators.

Table 6 – Prudential Indicators		Actual 2016/17	Target 2017/18	Position 31-Mar-18	Variance to target	
		£m	£m	£m	£m	%
PrI 1	Capital Expenditure	78.230	52.554	75.498	22.944	44%
PrI 2	Ratio of financing costs to net revenue stream	5.50%	11.00%	8.75%	(2.25%)	(20%)
PrI 3	Estimates of the incremental impact of new capital investment decisions on Council Tax	£7.98	£12.90	£12.90	0	0%
PrI 4	Capital Financing Requirement	335.150	344.171	351.593	7.422	2%
PrI 5	Authorised Limit for external debt	360.965	362.390	362.390	0.000	0%
PrI 6	Operational Limit for external debt	328.150	329.445	329.445	0.000	0%

Ref	Prudential Indicator	Actual 2016/17 £m	Target 2017/18 £m	Position 31-Mar-18 £m
PrI 7	Gross Borrowing exceeds capital financing requirement	No	No	No
PrI 8	Authority has adopted CIPFA Code of Practice for Treasury Management	Yes	Yes	Yes
PrI 9	Total principle sums invested for longer than 365 days must not exceed	5.0	25.0	14.0

Ref	Prudential Indicator	Upper Limit	Lower Limit	Actual 2016/17	Position 31-Mar-17
PrI 10	Fixed Interest Rate Exposure	95%	40%	**93%**	**94%**
PrI 11	Variable Interest Rate Exposure	45%	0%	**7%**	**6%**
PrI 12	***Maturity Structure of Borrowing:***				
	Under 12 months	25%	0%	**22%**	**26%**
	12 months and within 24 months	25%	0%	**13%**	**12%**
	24 months and within 5 years	40%	0%	**19%**	**21%**
	5 years and within 10 years	50%	5%	**12%**	**11%**
	10 years and above	85%	30%	**34%**	**29%**

PRL 5 (authorised limit for external debt) and PRL 6 (operational limit for external debt) were approved by Council on the 23 February 2017 and the CIPFA Code of Practice only allows these limits to be changed by Council and therefore the actual limit and the target remain the same. The actual debt position for the Council as at 31st March 2018 is £319.318m.

Key variances are because of the following reasons:-

<u>Prl 1 Total capital expenditure - variation of £22.944m</u>
The £52.554m target for 2017/18 is based on the figure for the 2017/18 capital programme reported in the budget report presented to full Council on the 23rd February 2017. The actual spend for 2017/18 is higher than the target due to amendments to the original capital programme agreed during the year, mainly in relation to the acquisition of a local shopping centre.

<u>Prl 2 Estimates of the ratio of financing costs to the net revenue stream variation of -20%</u>
Walsall's ratio of capital financing to total revenue costs is low, which demonstrated good performance. This is favourably less than target due to a prudency review of MRP during the year.

<u>Prl 4 Capital Financing Requirement variation of 2%</u>
Increase in actual capital investment being financed from borrowing was higher than the capital expenditure target in Prl1 for 2017/18 due to approved changes in the capital programme made in-year.

<u>Prl 12 Maturity Structure of Borrowing</u>
For the purpose of the maturity profile indicator the next call date on a LOBO loan is assumed; as it is the right of the lender to require repayment. However due to the low interest rate environment it is unlikely that in the medium term that any of the LOBO's will be called.

During 2017/18 the upper limit target for borrowing with a maturity of up to 12mths has been exceeded due to the timing and structure of the cash flow borrowing that was taken out to fund the approved upfront pension payment at the start of the year.

The lower limit for borrowing at maturities of over 10 years has also not been within the target set due to the borrowing requirements of the capital programme for the year being funded from cash during 2017/18 with longer term borrowing, to replenish this cash, being taken at the start of the new financial year.

5. Treasury Position at 31st March 2018

The council's debt and investment position is organised 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 detailed in the summary, and through officer activity detailed in the council's treasury management practices. At the beginning and the end of 2017/18 the council's treasury position was as shown below in **Table 7**:

Table 7 Loans and Investments	Opening Balance £m	Average Rate At 31/03/17 %	Movement in Year £m	Closing Balance £m	Average Rate At 31/03/18 %
PWLB loans	96.655	4.73%	16.837	113.492	4.06%
Market Loans	102.000	4.64%	0.000	102.000	4.64%
Bonds	0.332	2.60%	(0.299)	0.033	1.99%
Total Borrowing over 12 months excluding WMCC debt	**198.987**	**4.68%**	**16.538**	**215.525**	**4.33%**
Temporary Loans	54.597	0.60%	36.864	91.461	0.66%
Total borrowing excluding WMCC debt	**273.151**	**3.80%**	**51.961**	**325.112**	**3.26%**
WMCC Debt	19.567	6.50%	(1.441)	18.126	6.24%
Gross Borrowing	**273.151**	**3.99%**	**51.961**	**325.112**	**3.42%**
Waste Disposal & Cannock Chase Debtor	(6.261)	6.50%	0.467	(5.794)	6.24%
Borrowing	**266.890**	**3.94%**	**52.428**	**319.318**	**3.37%**
CFR less PFI finance & leases	324.130		19.407	343.537	
Under Borrowing	57.240		(33.021)	24.219	
Debt as % of CFR	**73%**			**93%**	
Call Accounts	10.230	0.30%	5.164	15.394	0.19%
Short Term Investments	139.000	0.90%	(39.500)	99.500	1.13%
Long Term Investments	5.000	1.56%	29.000	34.000	2.40%
Total Investments	**154.230**	**0.89%**	**(5.336)**	**148.894**	**1.32%**
Net Borrowing Position	**112.660**		**57.764**	**170.424**	

The under borrowing position the council has represents additional external borrowing the council could choose to take if required, however this has currently been financed by internal borrowing – utilising the Council's accumulated cash reserves rather than taking out new external borrowing. This position will continue to be monitored and additional external borrowing may be undertaken if required for cash flow purposes.

6. The Borrowing Strategy for 2017/18 and Economic Context

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 of 2019 and then only increase once more before the end of March 2020. There was an expectation that 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.

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.

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).

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.

As such, 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.

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.

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.

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.

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.

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.

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.

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.

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.

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.

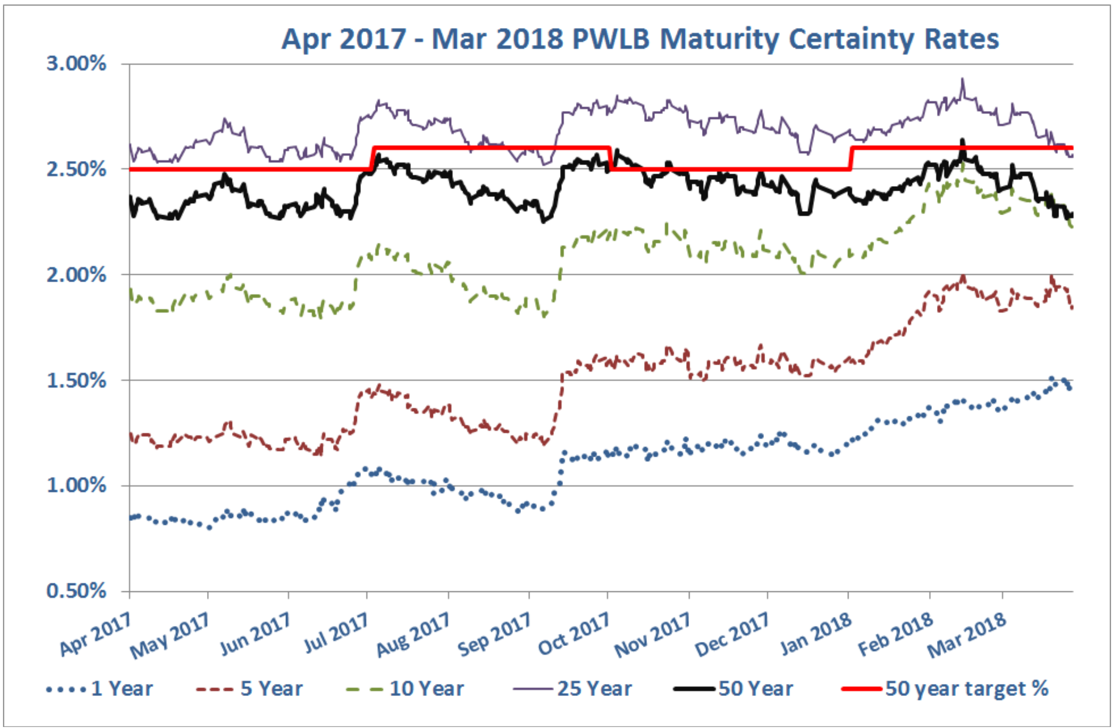
7. Borrowing Outturn for 2017/18

PWLB certainty maturity 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 quarters 1 and 3 and 2.60% in quarters 2 and 4.

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.



The council's long term borrowing (over 12 months in length) has increased in the year from £219m to £249m, to support the capital programme and the acquisition of an investment property during the year.

8. Investments in 2017/18 and Economic Context

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%, and reached a peak at the end of March.

Bank Rate was duly raised from 0.25% to 0.50% on 02/11/2017 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 28/02/2018.

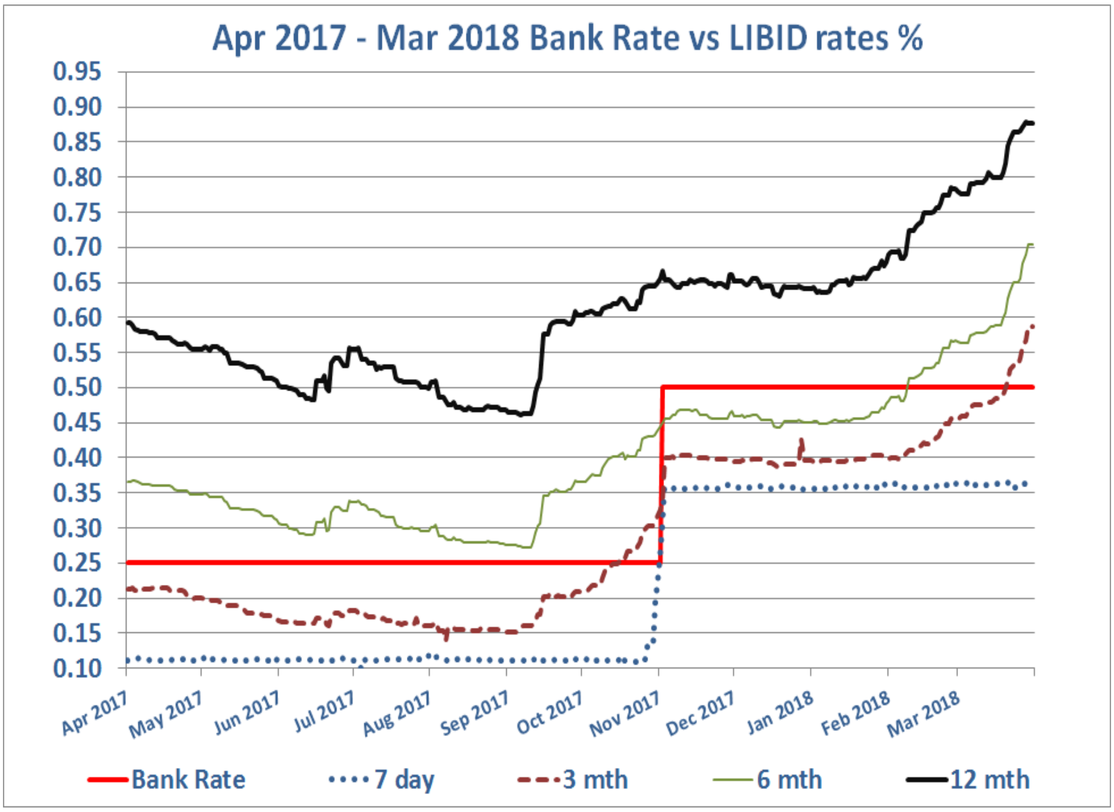


Table 9 within the report details the authority's investments by call, short and long term. The 7 day rate above (average of 0.235% across the year) is a fair comparator for at-call and the 12 month LIBID (average of 0.730% across the year) for short term investments.

Resources – the council's longer term cash balances comprise, primarily, revenue and capital resources, although these will be influenced by cash flow considerations.

Investment Policy – the council's investment policy is governed by central Government guidance, which was implemented in the Annual Investment Strategy approved by Council on 23rd February 2017. This policy set out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies supplemented by KPMG survey of Building Societies and an analysis of Common Equity Tier (CET1) levels. The investment activity during the year conformed to the approved Strategy, and the council had no liquidity difficulties.

At the end of 2017/18 Walsall's investment balance was £5.336m lower than that at the start of the year. **Table 8** below shows an age profile of the investments.

Table 8: Changes in Investments during 2017/18	Opening Balance £m	Closing Balance £m	Movement in Year £m
At Call accounts	10.230	15.394	5.164

Between 31 days and 365 days	139.000	99.500	(39.500)
Over 365 days	5.000	34.000	29.000
Total	**154.230**	**148.894**	**(5.336)**

Investments held by the council - the council maintained an average balance of £152m of internally managed funds. The internally managed funds earned an average rate of return of 1.32%. A comparable performance indicator is the average 12-month LIBID rate (which was 0.730%).

Recognising the continuation of the stresses on the world banking system, enhanced priority has continued to be given to security and liquidity. To reduce counterparty risk to the maximum possible extent the investment portfolio was spread across a range of appropriately credit rated / analysed institutions. **Table 9** shows the outturn on investment income in 2017/18.

Table 9 Investments Interest – Gross Income	2017/18 Approved Cash Limit £m	Outturn at 31 March 2018 £m	Over /(under) achieved cash limit £m	% Target Rate	% Average Rate achieved
Call Account investments	0.045	0.083	0.038	0.30%	0.19%
Short Term Investments	0.705	0.893	0.188	0.75%	1.13%
Long Term Investments	0.180	0.877	0.697	1.20%	2.40%
Total	**0.930**	**1.852**	**0.922**	**0.75%**	**1.32%**

9. Performance Measurement

One of the key requirements in the CIPFA Code of Practice on Treasury Management is the formal introduction of performance measurements relating to investments, debt and capital financing activities. **Table 10** below shows that Walsall has consistently achieved a higher average return on it's investments and has reduced it's average rate it pays for its borrowing. The figures for 2011/12 to 2014/15 are derived from the the CIPFA treasury management benchmarking club. For 2015/16 onwards, as a number of authorities no longer participate in this benchmarking exercise, the figures set out are based on a review of reports issued by the authorities statistical neighbours. Comparative figures for 2017/18 are not yet available.

Table 10 Comparison of Walsall with other councils Average Interest Rates	Walsall Rate Received %	Average Rate Received %	Walsall Rate Paid %	Average Rate Paid %
2011/12	1.80	1.20	4.53	4.53
2012/13	2.14	1.11	4.47	4.52
2013/14	1.29	0.85	4.51	4.26
2014/15	1.09	0.77	4.61	4.14
2015/16	1.08	0.76	4.54	4.18
2016/17	0.86	0.76	3.99	4.34

2017/18	1.32		3.42	

Council approved the following local performance indicators, the majority of which were complied with during the year, **Table 11** provides the indicators for March 2018.

Table 11 - Local Indicators		Actual 2016/17	Target 2017/18	Position 31-Mar-18	Variance to target	
		£m	£m	£m	value	%
L1	Full compliance with Prudential Code.	YES	YES	YES	N/A	N/A
L2	Average length of debt. (Years)	15.37	25.00	13.14	(11.86)	(47.45%)
L3a	Net borrowing costs as % of net council tax requirement.	17.74%	20.00%	7.61%	(12.39%)	(61.97%)
3b	Net borrowing costs as % of Tax Revenue.	10.88%	12.50%	4.57%	(7.93%)	(63.42%)
L4	Net actual debt vs. operational debt.	81.00%	85%	99.66%	14.66%	17.25%
L5	Average interest rate of external debt outstanding excluding OLA.	3.80%	4.61%	3.26%	(1.35%)	(29.32%)
L6	Average interest rate of external debt outstanding including OLA.	3.99%	4.72%	3.42%	(1.30%)	(27.44%)
L7	Gearing effect of 1% increase in interest rate.	1.80%	5.00%	3.47%	(1.53%)	(30.60%)
L8	Average interest rate received on STI vs. 7 day LIBID rate.	0.75%	0.50%	0.76%	0.26%	52.32%
L9	Average interest rate received:					
L9a	At Call investments.	0.30%	0.30%	0.23%	(0.07%)	(23.33%)
L9b	Short Term Investments.	0.90%	0.75%	1.06%	0.31%	41.33%
L9c	Long Term Investments.	1.56%	1.20%	1.85%	0.65%	54.17%
L10	Average interest rate on all ST investments (ST and At Call).	0.86%	0.68%	0.65%	(0.03%)	(4.41%)
L11	Average rate on all investments.	0.89%	0.77%	1.32%	0.55%	71.43%
L12	% daily bank balances within target range.	100%	98%	100%	2.00%	2.04%

Key variances are because of the following reasons:-

<u>L2. Average length of debt.</u>
The target for this indicator has not been met mainly due to the timing and structure of the cash flow borrowing that was taken out to fund the upfront pension payment at the start of the year.

L4. Net actual debt vs. operational debt.
The target was exceeded in this area due to additional borrowing taken out after the target was set, linked to approved changes to the capital programme made during the year.

L9a. At call investments
The original target for this indicator has not been met as a result of the rate offered on the council's main At Call account being reduced following the reduction in the Bank of England base rate (there was a slight delay in the counterparty passing this reduction on due to a contractual requirement for them to continue to offer the previous rate until June 2017).

L10. Average interest rate on all ST investments (ST and AT call)
The actual delivery in this area for the year has been affected by the result of the At Call rate achieved being impacted as set out in L9a. above.

Local Authority Mortgage Scheme.

Under this scheme the council placed funds of £2m with Lloyds for a period of 5 years. This was classified as being a service investment, rather than a treasury management investment, and is therefore outside of the specified / non specified investment categories. At 31st March 2018 the scheme has now reached the end of the 5 year period and the authority received its £2m funds back during the year.