Agenda Item No:10

TREASURY MANAGEMENT QUARTER FOUR

To:	**General Purposes Committee**		
Meeting Date:	**29 May 2018**		
From:	**Chief Finance Officer**		
Electoral division(s):	**All**		
Forward Plan ref:	**Not applicable**	*Key decision:*	**No**
Purpose:	**To provide the fourth quarterly update on the Treasury Management Strategy 2017-18 , approved by Council in February 2017.**		
Recommendation:	**The General Purposes Committee is recommended to note the Treasury Management Quarter Four Report for 2017-18 and forward to full Council to note.**		

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1. BACKGROUND

1.1 Treasury Management is governed by the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management (the Code). The Code has been developed to meet the needs of Local Authorities and its recommendations provide a basis to form clear treasury management objectives and to structure and maintain sound treasury management policies and practices.

1.2 The Code was adopted via the Treasury Management Strategy Statement (TMSS), which was approved by Council in February 2017. It requires the Council to produce an annual treasury report and a half yearly report. Alongside these, General Purposes Committee is also provided with quarterly updates on progress against the Strategy. This report meets the requirement of the annual treasury report.

1.3 This report has been developed in consultation with the Council's external investment manager and treasury adviser, Link Asset Services (LAS) and provides an update for the fourth quarter to 31 March 2018 as well as reporting the financial outturn on the debt financing budgets.

2. KEY HEADLINES

2.1 The main highlights for the quarter are that:

a) Investment returns received on cash balances, compare favourably to the 7 Day London Interbank Bid Rate benchmark. A return of 0.41% was achieved compared to the 7 day and 3 month London Interbank Bid Rate (LIBID) benchmark (0.36%, 0.44% respectively). See section 6.

b) An underspend of £1.980m was delivered for the debt charges budget this year. Net payments were less than budgeted because fewer long term loans were raised during the year than had been budgeted. Temporary, short term loans at low rates of interest were raised instead to meet liquidity needs. In addition the Council exercised an option to repay a £4m loan from Siemens in March which was refinanced with short term borrowing at a significantly lower rate of interest. Minimum Revenue Provision (MRP) was less than budgeted as a consequence of profiling and alternate funding of capital expenditure." For further information please see Section 9.

c) This report reflects the revised Authorised Borrowing Limit and Operational Boundry which was restated and approved by Council in the Treasury Management Strategy presented at the February 2018 Council meeting. Therefore these limits will have increased compared to the previously reported limits in the quarter 3 treasury report.

d) Third party loans have increased as at 31 March 2018 due to loans made to This Land Limited with principal outstanding of £28.17m. This increase in third party loans is reflected throughout the report where appropriate.

3. THE ECONOMIC ENVIRONMENT

3.1 A current economic commentary is provided in **Appendix 1**, which has been provided by Link Asset Services (formerly Capita Asset Services), the Council's treasury management advisors.

3.2 During the quarter ended 31st March 2018, the significant UK headlines of this analysis were that:

- The economy broadly maintained the same pace as in Q4 2017;
- The tightness in the labour market fed through to higher wage growth;
- Consumer price inflation eased from its recent peak;
- The Monetary Policy Committee (MPC) signalled its intention to bring Consumer Prices Index (CPI) inflation back to target over a shorter time horizon;
- Market expectations of a May increase in Bank Rate solidified (although subsequently this has not happened);
- Public sector borrowing undershot the Office for Budget Responsibility's forecasts;
- The UK and EU agreed on a 21-month transition period in respect of Brexit; and
- Financial markets were buffeted by prospects of rising US interest rates and a global trade war.

4. SUMMARY PORTFOLIO POSITION

4.1 Net debt at 31 March 2018 stands at £471m which is higher than originally set out in the Treasury Management Strategy Statement in February 2017 by £5m. This is due to the increase in the Capital Financing Requirement (CFR) driven by changes in the capital programme and the loans to This Land Limited offset by the cash balances and reserves used for internal borrowing purposes. A balance sheet review will be carried out once draft financial statements become available in June which will provide useful detailed analysis of the Councils loans and investments in relation to the Capital Financing Requirement and reserves.

4.2 Further analysis on borrowing and investments is set out in the next two sections.

4.3 A snapshot of the Council's debt and investment position is shown in the table below:

	TMSS 2017-18 31 Mar 2018 Forecast (as agreed by Council Feb 2017)		Actual as at 31 March 2017		Actual as at 31 March 2018		Change from Mar 2017 to Mar 2018
	£m	Rate %	£m	Rate %	£m	Rate %	£m
Long term borrowing							
PWLB	439.4	4.5	278.6	4.3	278.6	4.5	-
PWLB (3rd Party Loans)	-	-	3.9	2.3	3.76	2.3	(0.14)
Market	-	-	45.0	4.0	65.0	2.6	20.0
LOBO	34.5	3.6	19.5	3.6	15.5	3.6	(4.0)
Total long term	**473.9**	**4.3**	**347.0**	**4.3**	**362.86**	**3.98**	**15.86**
Short term borrowing	-	-	92.0	0.4	135.0	0.8	43.0
Total borrowing	**473.9**	**4.3**	**439.0**	**3.4**	**497.86**	**3.0**	**58.86**
Investments	**7.9**	**0.5**	**40.5**	**0.3**	**26.42**	**0.3**	**14.08**
Total Net Debt / Borrowing	**466.0**	**-**	**398.5**	**-**	**471.44**	**-**	**72.94**
3rd Party Loans & Share Capital	**-**	**-**	**4.3**	**-**	**32.33**	**-**	**28.03**

5. BORROWING

5.1 The Council can take out loans in order to fund spending for its Capital Programme. The actual amount of new borrowing required each year is determined by capital expenditure plans, capital funding available, the actual Capital Financing Requirement (CFR), forecast reserves and current and projected economic conditions.

New loans and repayment of loans:

5.2 This section shows details of new long term loans (i.e. loans that are greater than 1 year) raised and loans repaid during this quarter. During quarter 4 three long term loans were drawn down from other local authorities with 2 loans totalling £5m each for a term of 2 years and 1 loan totalling £10m for a period of 1 year. These were drawn down at interest rates of 1.4% and 1.3% for the 2 year loans which compares to the PWLB certainty rate for 2 year loans of around 1.5%. The 1 year loan is borrowed at a rate of 0.85%.

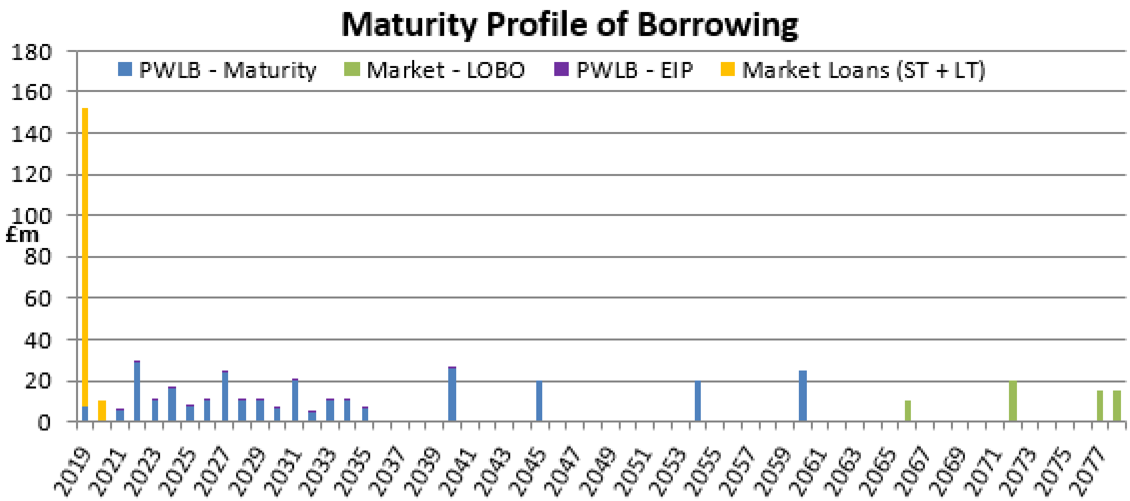
5.3 An option in a loan contract with Siemens Financial Services allowed the Council to repay a £4m loan before the final maturity date in March 2028 and to refinance with cheaper short term borrowing.

5.4 In addition a number of short term loans have been drawn down during 2017-18 as the Council experiences an increasing Capital Financing Requirement. Short term loans are typically drawn from other local authorities, which is a well established arrangement and operates well for authorities to loan out at other similar bodies as an alternative investment approach for surplus cash balances. All of the authorities short term loans totalling £135m are with other public bodies and all have a term of less than 1 year.

Maturity profile of borrowing:

5.5 The following graph below shows the maturity profile of the Council's loans. The majority of loans are PWLB loans and have a fixed interest rate and are long term in nature which limits the Council's exposure to interest rate fluctuations. The weighted average years to maturity of the overall portfolio (assuming LOBO Loans run to maturity) is 16 years.

5.6 The presentation of the graph below differs from that in the Treasury Indicator for maturity structure of borrowing in **Appendix 3** paragraph 4 because the graph below includes LOBO loans at their final maturity rather than their next call date. In the current low interest rate environment the likelihood of the interest rates on these loans being raised and the loans requiring repayment at the break period is considered to be low.



Loan restructuring:

5.7 When market conditions are favourable long term loans can be restructured to:

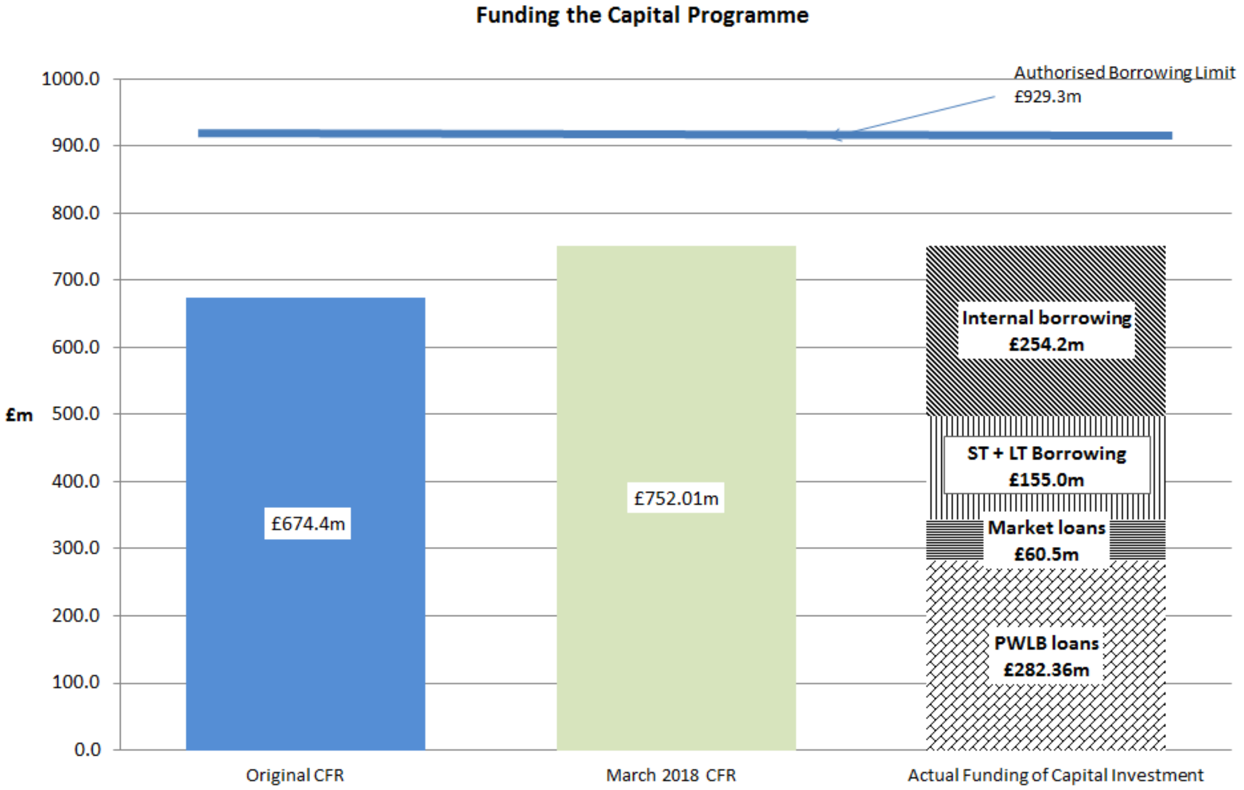
- to generate cash savings;
- to reduce the average interest rate; and / or
- to enhance the balance of the portfolio by amending the maturity profile and/or the level of volatility (volatility is determined by the fixed/variable interest rate mix).

5.8 During the quarter there were no opportunities for the Council to restructure its borrowing due to the position of the Council's borrowing portfolio compared to market conditions. Debt rescheduling in 2018-19 will continue to be kept under review and considered subject to conditions being favourable. If and when opportunities for savings do arise, debt rescheduling will be undertaken to meet business needs.

Funding the Capital Programme:

5.9 The Treasury Management Strategy Statement (TMSS) set out the plan for treasury management activities over the year. It identified the expected level of borrowing and investment levels. When the 2017-18 TMSS was set, it was anticipated that the Capital Financing Requirement (CFR), the Council's liability for financing the agreed Capital Programme, would be £674.4m. This figure is naturally subject to change as a result of changes to the approved capital programme.

5.10 The chart below compares the maximum the Council could have borrowed in 2017-18 alongside the CFR at 31 March 2018 (£752.01m) and how the CFR is currently being financed as at 31 March 2018. The CFR has increased from the value set out in the TMSS due to loans made to This Land and increases in the Council's capital programme.



5.11 As shown on the chart above, it can be seen that the council's current CFR is £177.3m below the statutory Authorised Borrowing Limit set for the Council. It should be noted that the 2017-18 Authorised Borrowing Limit was revised in the TMSS 2018 approved by Council from £733.4m to £929.3m, which is reflected in the chart above.

5.12 In addition, the chart shows how the Council is currently funding its borrowing requirement (through internal and external resources). At 31 March, based on current projections of the CFR, internal borrowing is expected to be approximately £254.2m. Internal borrowing is the use of the Council's surplus cash to finance the borrowing liability instead of borrowing externally.

5.13 The Council has now maximised this internal borrowing position to optimise the treasury position, reduce credit risk associated with investing and generate revenue savings. Therefore new loans, which have been budgeted for, will be required to maintain sufficient operational cash resources and to finance transactions with This Land. Sources of finance include short term loans (out to 5 years) from other local authorities, the PWLB and the Municipal Bonds Agency.

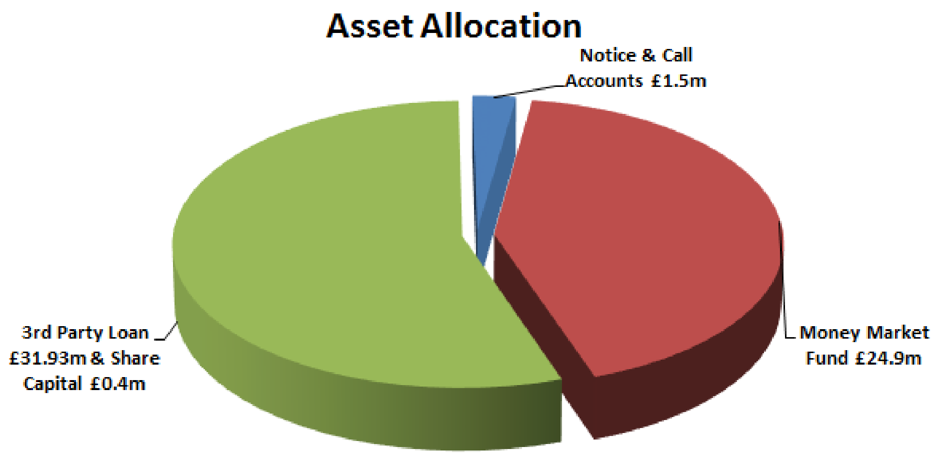
6. INVESTMENTS

6.1 Investment activity has been carried out within the Council's counterparty policies and criteria, and with a clear strategy of risk management in line with the Council's Treasury Management Strategy for 2017-18. This ensures that the principle of considering security, liquidity and yield, in that order (SLY), is consistently applied. The Council therefore aims to achieve the optimum return on investments commensurate with proper levels of security and liquidity. Any variations to agreed policies and practices are reported to GPC and Council.

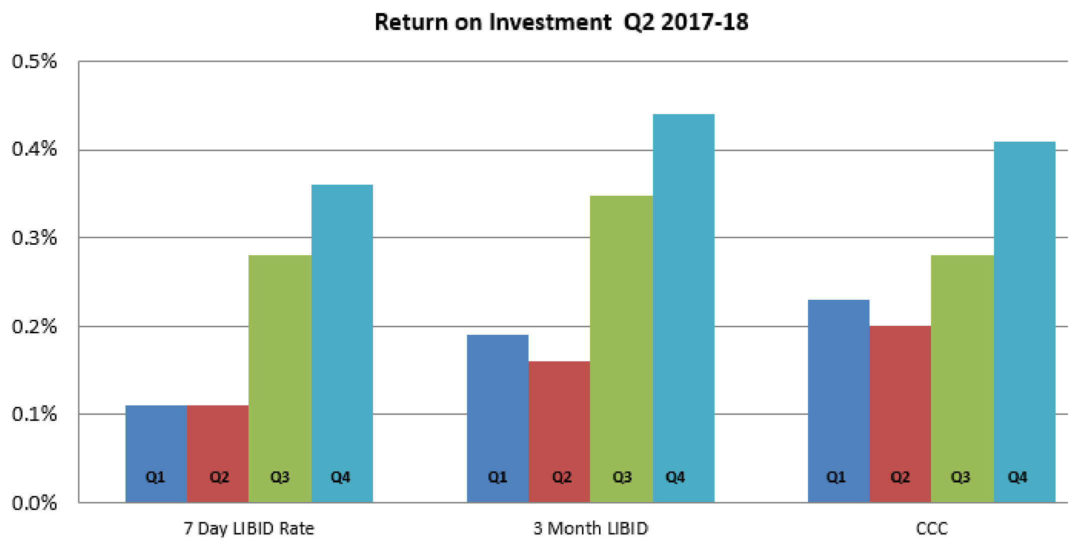
6.2 As described in paragraph 5.12, the strategy currently employed by the Council of internal borrowing also has the affect of limiting the Council's investment exposure to the financial markets, thereby reducing credit risk.

6.3 As at 31 March 2018 the level of investment totalled £26.42m, excluding 3rd party loans and share capital which are classed as capital expenditure. Third party loans and share capital total £32.33m relating to an equity share in the Municipal Bonds Agency (£0.4m), a loan to the Arthur Rank Hospice Charity (£3.76m) and loans to This Land (£28.17m). The level of cash available for investment is as a result of reserves, balances and working capital the Council holds. These funds can be invested in money market deposits, placed in funds or used to reduce external borrowings.

6.4 A breakdown of investments by asset allocation are shown in the graph overleaf, with detail at **Appendix 2**. The majority of investments are in notice and call accounts and money market funds to meet the liquidity demands of the Council. The weighted average time to maturity of investments at 31 March is 1 day. Where possible deposits are placed for longer durations with appropriate counterparties to obtain enhanced rates of return.



6.5 The graph below compares the returns on the Council's investments with the relevant benchmarks for each quarter during the 2017-18 financial year.



6.6 It can be seen from the graph that investments returned 0.41% during quarter 4 which is more than the 7 day LIBID (0.36%), but less than the 3 month LIBID (0.44%) benchmarks.

6.7 Using credit ratings, the investment portfolio's historic risk of default stands at 0.0001%. This simply provides a calculation of the possibility of average default against the historical default rates. The Council is also a member of a benchmarking group run by LAS which shows that, for the value of risk undertaken and duration of investments, the returns generated are currently below the Model Band. This is because the Council maintains low cash balances compared to the size of its balance sheet, and a high proportion of these balances are held in a low interest bearing instant access account with Barclays, to meet business needs.

6.8 Leaving market conditions to one side, the Council's return on investment is influenced by a number of factors, the largest contributors being the duration of investments and the credit quality of the institution or instrument. Credit risk is a measure of the likelihood of default and is controlled through the creditworthiness policy approved by Council. The duration of an investment introduces liquidity risk; the risk that funds can't be accessed when required, and interest rate risk; the risk that arises from fluctuating market interest rates. These factors and associated risks are actively managed by the LGSS Integrated Treasury team together with the Council's Treasury Advisors (LAS).

7. INTEREST RATE OUTLOOK

7.1 The performance of the economy over the coming months will be critical for any further monetary policy easing or tightening. Commentators on the bank base rate have stated that there may be the potential for a rate rise in August 2018 whilst others are citing a rate rise in November 2018. In essence the timing of any rate rise is uncertain and dependent on the Monetary Policy Committee view of various factors at the point at which it meets. Any rate rise will very much depend on how strongly and how soon the economy makes a gradual recovery, and so start a process of very gradual increases in Bank Rate over a prolonged period. Current interest rate forecasts from Link Asset Services are shown in the table below.

Link Asset Services Interest Rate View												
	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate View	0.50%	0.50%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%
3 Month LIBID	0.60%	0.70%	0.90%	0.90%	0.90%	1.10%	1.20%	1.30%	1.40%	1.50%	1.60%	1.60%
6 Month LIBID	0.70%	0.80%	1.00%	1.00%	1.00%	1.20%	1.20%	1.30%	1.50%	1.60%	1.70%	1.70%
12 Month LIBID	0.80%	0.90%	1.10%	1.10%	1.20%	1.30%	1.40%	1.40%	1.60%	1.70%	1.80%	1.80%
5yr PWLB Rate	1.90%	2.00%	2.00%	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.40%	2.50%	2.50%
10yr PWLB Rate	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%
25yr PWLB Rate	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%	3.50%	3.50%
50yr PWLB Rate	2.40%	2.50%	2.60%	2.70%	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%

7.2 Geopolitical events, sovereign debt crisis developments and slowing emerging market economies make forecasting PWLB rates highly unpredictable in the shorter term. The general expectation for an eventual trend of gently rising gilt yields and PWLB rates is expected to remain unchanged. An eventual world economic recovery may also see investors switching from the safe haven of bonds to equities.

7.3 From a strategic perspective, the Council is continually reviewing options as to the timing of any potential borrowing and also the alternative approaches around further utilising cash balances and undertaking shorter term borrowing which could potentially generate savings subject to an assessment of the interest rate risks involved. Cash flows in the last couple of years have been sufficiently robust for the Council to use its balance sheet strength to limit the amount of new long term borrowing undertaken.

8. THIRD PARTY LOANS

8.1 A loan to Arthur Rank Hospice Charity of £4m was approved in 2015-16 and advanced in the form of a secured loan in June 2016 to enable the charity to build a 24 bedded hospice.

8.2 Interest and principal repayments for this loan have been made accordance with the loan agreements. The principal outstanding for this loan is £3.76m as at 31 March 2018.

8.3 During 2017-18 loans have also been advanced to This Land Limited, the Council's wholly owned housing development company. As at 31 March 2018 the principal outstanding with This Land totals £28.17m, which is comprised of three separate loans of £2.80m, £2.04m and £23.3m. Further loans to This Land are expected during 2018-19.

9. DEBT FINANCING BUDGET

This section summarises the 2017-18 expenditure and income for debt financing, which is held as a central budget within Corporate Services, and complies with the reporting requirements in the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management. The overall outturn position against the various debt financing budgets is an underspend of £1.98m, which is explained below.

	Budget	**Outturn**	**Variance**
	£m	**£m**	**£m**
Interest payable	16.071	14.948	(1.123)
Interest receivable	(1.597)	(2.391)	(7.94)
Technical & Other	(1.724)	222	1.946
MRP	11.477	9.467	(2.010)
Total	**24.227**	**22.246**	**(1.981)**

9.1 Net payments were less than budgeted because fewer long term loans were raised during the year than had been budgeted. Temporary, short term loans at low rates of interest were raised instead to meet liquidity needs. In addition the Council exercised an option to repay a £4m loan from Siemens in March which was refinanced with short term borrowing at a significantly lower rate of interest. Minimum Revenue Provision (MRP) was less than budgeted as a consequence of profiling and alternate funding of capital expenditure.

9.2 The change in the authority's loan debt over the year was as follows:

	1st April 2017 £'000	Loans Raised £'000	Loans Repaid £'000	31st March 2018 £'000
Long-Term Debt	347,020	19,840	4,000	362,860
Temporary Debt	92,000	43,000	-	135,000
	439,020	62,840	4,000	497,860
Less Investments	40,454			26,424
Net Debt	**398,566**			**471,436**

9.3 Long-term debt consists of loans for periods exceeding one year (at either fixed or variable rates of interest) and the average rate of interest paid on this long-term debt was 4.10%. The average rate paid on short term debt was 0.75%.

9.4 Each year the authority must approve limits known as Prudential Capital Indicators for the level of its external financing costs and the maximum limits on total debt. The outcome for 2017/18 compares with approved limits as set out below in the table below.

9.5 Financing costs for the year were within the approved limit as a result of the underspend for debt charges, and all debt levels are within the approved limits.

	Approved £'000	Actual £'000
Financing Costs		
% of Net Revenue Expenditure	10.5%	5.86%
Authorised Limit for Debt	929,300[3]	497,860
Operational Boundary for Debt	899,300[3]	497,860
Interest Rates Exposure (as % of total net debt)[1]		
Fixed Rate	150%	76.97%
Variable Rate	65%	23.03%
Debt Maturity (as % of total debt)[2]		
Under 1 year	0 – 80%	34%
1 – 2 years	0 – 50%	1%
2 – 5 years	0 – 50%	10%
5 – 10 years	0 – 50%	14%
Over 10 years	0 – 100%	42%

Notes:

1. The Interest Rate Exposure is calculated as a percentage of net debt.
2. The guidance for this indicator required that LOBO loans are shown as maturing at the next possible call date rather than at final maturity.
3. The Operational Boundary and Authorised Borrowing Limit were restated and approved by Council as part of the TMSS 2018 at the February 2018 Council meeting.

10. MUNICIPAL BONDS AGENCY

10.1 The UK Municipal Bonds Agency (MBA) is now ready to issue bonds on behalf of local authorities. Marketing activities are underway by the MBA to find suitable investors as part of the first issuance. It is expected that the MBA wil be issuing its first bond in the near future. The authority has approved the relevant documents and guarantees that allow borrowing from the Agency and it is expected that Cambridgeshire will participate in the first bond issue when available.

11. COMPLIANCE WITH TREASURY LIMITS AND PRUDENTIAL INDICATORS

11.1 With effect from 1st April 2004 The Prudential Code became statute as part of the Local Government Act 2003 and was revised in 2011.

11.2 The key objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of the Council are affordable, prudent and sustainable. To ensure compliance with this the Council is required to set and monitor a number of Prudential Indicators.

11.3 During the financial year to date the Council has operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Management Strategy Statement (TMSS) and in compliance with the Council's Treasury Management Practices. The Prudential and Treasury Indicators for the 2017-18 year are reported in Appendix 3.

12. ALIGNMENT WITH CORPORATE PRIORITIES

12.1 **Developing the local economy for the benefit of all**
There are no significant implications for this priority.

12.2 **Helping people live healthy and independent lives**
There are no significant implications for this priority.

12.3 **Supporting and protecting vulnerable people**
There are no significant implications for this priority.

13. SIGNIFICANT IMPLICATIONS

13.1 Resource Implications

This report provides information on performance against the Treasury Management Strategy. Section 9 shows the impact of treasury decisions impacting the Debt Charges Budget, which are driven by the capital programme and the Council's overall financial position.

13.2 Procurement/Contractual/Council Contract Procedure Rules Implications

There are no significant implications in this category.

13.3 Statutory, Legal and Risk Implications

The Council continues to operate within the statutory requirements for borrowing and investments. Further details can be found within the Prudential Indicators in Appendix 2.

13.4 Equality and Diversity Implications

There are no significant implications in this category.

13.5 **Engagement and Communications Implications**

There are no significant implications in this category.

13.6 **Localism and Local Member Involvement**

There are no significant implications in this category.

13.7 **Public Health Implications**

There are no significant implications in this category.

Source Documents	**Location**
None	N/A

Implications	**Officer Clearance**
Have the resource implications been cleared by Finance?	Yes Name of Financial Officer: Tom Kelly
Have the procurement/contractual/ Council Contract Procedure Rules implications been cleared by Finance?	No Name of Officer: n/a
Has the impact on Statutory, Legal and Risk implications been cleared by LGSS Law?	Yes Name of Legal Officer: Fiona McMillan
Have the equality and diversity implications been cleared by your Service Contact?	No Name of Officer: n/a
Have any engagement and communication implications been cleared by Communications?	No Name of Officer: n/a
Have any localism and Local Member involvement issues been cleared by your Service Contact?	No Name of Officer: n/a
Have any Public Health implications been cleared by Public Health	No Name of Officer: n/a

Appendix 1

Economic Update
Quarter Ended 31 March 2018

The economic commentary below has been provided by Link Asset Services, the Council's treasury management advisors. This is not a representation of the Council's view on the economic outlook.

1. During the quarter ended 31 March 2018:

   - The economy broadly maintained the same pace as in Q4 2017;
   - The tightness in the labour market fed through to higher wage growth;
   - Consumer price inflation eased from its recent peak;
   - The MPC signalled its intention to bring CPI inflation back to target over a shorter time horizon;
   - Market expectations of a May increase in Bank Rate solidified;
   - Public sector borrowing undershot the Office for Budget Responsibility's forecasts;
   - The UK and EU agreed on a 21-month transition period in respect of Brexit;
   - Financial markets were buffeted by prospects of rising US interest rates and a global trade war.

2. The latest Quarterly National Accounts showed that **the economy grew by 0.4% in Q4 2017, and growth for 2017 as a whole was revised up to 1.8%,** broadly unchanged from growth in 2016. Although this gives little reason to cheer, annual growth was at least far higher than many had initially predicted after the Brexit vote and growth overall was more balanced, with net trade providing a boost and annual investment growth rising by a healthy 4.0%.

3. The weakness in **consumer spending growth** provided the biggest constraint on GDP growth last year, rising by only 1.7%, its lowest rate since 2012, and this softness looks as if it has also continued during Q1 2018. Growth in retail sales volumes was sluggish in January and February and the heavy snowfall is likely to have dented consumer spending in March. However, the weakness should only be temporary as inflation continues to fall further below the level of average wage growth during 2018.

4. The Markit/CIPS all-sector PMI points to quarterly **GDP growth of around 0.4% in Q1** so far, suggesting that the economy failed to gather much momentum at the start of 2018. The official output data for January also looks quite bleak. Underlying growth in overall industrial production was weak and the construction sector remains in recession. One bright spot is the manufacturing sector, which has experienced its longest consecutive run of monthly output growth since 1968 and should continue to benefit from a strong external environment and greater

international competitiveness due to the weaker pound. However, recent data suggests that manufacturing growth may have lost some of its pace so far this year.

5. There were though, some encouraging signs elsewhere in the economy. **The labour market** appears to have recovered from its weakness at the end of Q4, with employment jumping by an impressive 168,000 in the three months to January and the unemployment rate falling back to 4.3%. Survey evidence of hiring intentions suggests that this strength persisted throughout the quarter.

6. What's more, there are now clearer signs that the tightness in the jobs market is feeding through to higher nominal pay growth. Annual growth in the three-month average of **weekly earnings** (including bonuses) picked up to 2.8% in January – its highest rate since September 2015. With survey measures of pay settlements strong, and evidence of recruitment difficulties rising, further acceleration in nominal pay growth looks likely over the coming quarters.

7. At the same time, **CPI inflation** has fallen back to 2.7% in February from 3.0% in January, where it had remained stuck for five months. The fall was driven by easing inflation in the prices of import-intensive goods and services as well as energy prices. This is likely to mark the start of a sustained and gradual fall in inflation this year as the peak impact of sterling's past depreciation appears to have passed.

8. Admittedly, the downward trend in **CPI inflation** over the next few months may not be smooth. Base effects helped pull the inflation rate down in February and may not have the same effect in March. What's more, Brent crude prices rose sharply in March from around £46pb to over £49pb, which is likely to put upward pressure on firms' costs and wholesale energy prices. The bigger picture though, is that the main force pushing up inflation over the past year or so, (the depreciation in sterling), is fading and this has helped to end the real terms pay squeeze. This will provide welcome relief for consumers' finances and give a fillip to consumer spending over the rest of the year.

9. But even with CPI inflation expected to ease over the course of 2018, the **MPC** acknowledged in its March meeting that domestic inflationary pressures are building, in particular labour costs. Given that there is very little spare capacity left in the economy, the Bank of England is becoming less tolerant of letting CPI inflation overshoot its 2% target. Indeed, the February Inflation Report signalled the Bank's intentions of bringing inflation back to target over a more "conventional" time horizon, (i.e. 18-24 months rather than 2-3 years). The minutes from the March meeting also struck a relatively hawkish tone with 2 members voting to raise rates. The market-implied probability of a May rate hike is now over 70%, compared with 35% in January.

10. Elsewhere, there were few big changes to fiscal policy in the first quarter, with the **Spring Statement** including only updates to the OBR's forecasts, of which changes were few and far between. The OBR judged that the higher-than-expected GDP growth in 2017 and upwardly-revised growth in 2018 of 1.5% would come at the

expense of lower future growth, i.e. it was deemed cyclical rather than an improvement in the economy's potential. As a result, changes in the borrowing forecasts mean that the Chancellor has roughly the same amount of wiggle room in 2020/21 as he had in November. However, despite his hands being tied by the OBR, the Chancellor hinted at providing a giveaway in the Autumn Budget.

11. **Public sector net borrowing** has so far come in lower for 2017/18 than in 2016/17, and while there has been a bit of a deterioration in the finances over the start of 2018 due to the weakness in self-assessment tax receipts, borrowing still looks likely to undershoot the OBR's 2017/18 forecast by around £2bn.

12. Meanwhile, the first quarter saw some important progress in **Brexit negotiations**. Crucially, the UK and EU agreed on a transition period lasting until the end of 2020, reducing the risk of a cliff-edge scenario from March 2019. The transition period largely preserves the status-quo, with the UK maintaining membership of the single market and customs union. However, the UK made increasing numbers of concessions such as forfeiting its voting rights on EU law and on granting EU citizens' permanent residency in the UK during the transition period in order to move onto negotiations regarding the future relationship with the EU.

13. Of particular note was the inclusion of a "backstop" option that would in effect see **Northern Ireland** remain in the single market and customs union if no specific solution to the Irish border issue is found. In order to maintain the constitutional integrity of the United Kingdom, (i.e. to avoid a border in the Irish Sea between Northern Ireland and Great Britain), and honour the Good Friday agreement, (i.e. to avoid a hard border between Ireland and Northern Ireland), the UK government will need to substantially soften its stance on cutting its EU ties going into the negotiations on the future agreement, and may end up having to concede on its pledge to leave the customs union entirely.

14. **Equity markets** were on something of a rollercoaster throughout Q1. First, global equity markets plummeted at the start of February due to a reassessment of the path for US inflation and interest rates. Then, fears of a global trade war following on from heightened protectionism in the US which targeted China with new tariffs, prompted investors to flee risky assets - which hit stock markets globally. President Trump's tariffs on steel and aluminium imports would only affect around 0.1% of UK GDP so there is no discernible impact on the UK economy. Instead, the threat comes from any EU retaliation and the impact on the US stock market - which could be contagious for UK equities. The FTSE ended the quarter some 8% below its value at the start of the year, and remains vulnerable, while other stock markets managed to recover some of their losses.

15. Meanwhile, the **trade-weighted sterling index** appreciated by around an average of 2.6%, gaining 4.6% against the dollar while only rising by 1.2% against the euro. The 10-year gilt yield rose sharply in the first half of the quarter due to rising interest rate expectations. This was partly offset in the second half by a fall back in inflation

expectations and an increase in safe-haven flows, alongside gold, as investor sentiment soured amidst the market turbulence in March. Overall, the 10-year gilt rose by around 0.2pp to end March near 1.4%.

16. Internationally, the **US Federal Reserve** hiked interest rates in March by 25bp, taking the Fed funds range to 1.50%-1.75%. The Fed's median expectations for US GDP growth for 2018 and 2019 were revised up, on account of the additional fiscal stimulus, and inflation was also nudged higher. With the economy now expected to expand faster than trend over the next few years, the Fed signalled a faster pace of monetary tightening than before, with the median projection of the Fed funds rate at 2.9% by end-2019, up from 2.7%.

17. Elsewhere, while the **eurozone** economy continued to expand at a strong pace, survey indicators suggest that growth may have peaked in 2017 at 2.5%. The strength in the economy prompted the ECB to remove its loosening bias in March and signal an end to its asset purchases this year. However, inflationary pressures remain persistently weak, meaning it will probably be some time before the ECB begins to withdraw its monetary support.

Appendix 2

Investment Portfolio as at 31stMarch 2018

Class	Type	Deal Ref	Start / Purchase Date	Maturity Date	Counterparty	Profile	Rate	Principal O/S (£)
Share Capital	Share Capital	CCC/59	25/09/14	25/09/24	The UK Municipal Bonds Agency	-	-	400,000.00
3rd Party Loan	Fixed	CCC/88	16/06/16	16/06/41	Arthur Rank Hospice Charity	EIP	3.3400%	3,760,000.00
3rd Party Loans & Share Capital Total							**3.3400%**	**4,160,000.00**
Deposit	Call	CCC/CE/6	01/12/14		Barclays Bank plc	Maturity	0.4000%	1,507,000.00
Call Total							**0.1500%**	**1,507,000.00**
Deposit	MMF	CCC/ST/7	22/07/15		Deutsche Managed Sterling Platinum	Maturity	0.4228%	4,917,000.00
Deposit	MMF	CCC/ST/3	31/03/14		SLI Sterling Liquidity/Cl 2	Maturity	0.4624%	20,000,000.00
MMF Total							**0.4546%**	**24,917,000.00**
Deposit Total							**0.8007%**	**30,584,000.00**
Grand Total								**30,584,000.00**

Notes

a) The Investment Portfolio table above is an extract from the Treasury Live system which does not yet include the loans made to This Land, this will be updated in the Treasury Live system for future reports in 2018-19. The value of loans made to This Land in 2017-18 total £28.17m.

b) As a result of the loans to This Land the Grand Total of the Investment Portfolio is £58.75m made up of £30.58m (as per the above) plus This Land loans of £28.17m.

Appendix 3

Prudential and Treasury Indicators at 31st March 2018

Monitoring of Prudential and Treasury Indicators: approved by Council in February 2017.

1. **Has the Council adopted CIPFA Code of Practice for Treasury Management in the Public Services?**

   The Council has adopted CIPFA's Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes. This is a key element of the Treasury Strategy 2017-18 which was approved by Council in February 2017.

2. **Limits for exposure to fixed and variable rate net borrowing (Borrowing less investments)**

	Limits	Actual
Fixed rate	150%	76.97%
Variable rate	65%	23.03%
Total		100%

The Interest rate exposure is calculated as a percentage of net debt. Due to the mathematical calculation exposures could be greater than 100% or negative depending upon the component parts of the formula. The formula is shown below:

$$\frac{\textit{Total Fixed (or Variable) rate exposure}}{\textit{Total borrowing – total investments}}$$

Fixed Rate calculation:

$\frac{\textit{(Fixed rate borrowing £362.86m* - Fixed rate investments £0m*)}}{\textit{Total borrowing £497.86m - Total investments £26.42m}}$	*= 76.97%*

*Defined as greater than 1 year to run

Variable Rate calculation:

$\frac{\textit{(Variable rate borrowing £135m** - Variable rate investments £26.42m**)}}{\textit{Total borrowing £497.86m - Total investments £26.42m}}$	*= 23.03%*

** Defined as less than 1 year to run or in the case of LOBO borrowing the call date falling within the next 12 months.

3. **Total principal sums invested for periods longer than 364 days**

	2017-18 Limit £m	Actual £m
Investment longer than 364 days to run	0.0	0.0

Notes: This indicator is calculated by adding together all investments that have greater than 364 days to run to maturity at the reporting date.

4. **Limits for maturity structure of borrowing**

	Upper Limit	Actual
under 12 months	80%	34%
12 months and within 24 months	50%	1%
24 months and within 5 years	50%	10%
5 years and within 10 years	50%	14%
10 years and above	100%	42%

Note: The guidance for this indicator requires that LOBO loans are shown as maturing at the next possible call date rather than at final maturity.

Affordability

5. **Ratio of financing costs to net revenue stream**

2017-18 Original Estimate %	2017-18 Revised Estimate %	Difference %
7.70	5.86	-1.84

6. **Estimated incremental impact of capital investment decisions on band D council tax**

2017-18 Original Estimate £	2017-18 Revised Estimate £	Difference £
11.38	11.75	0.37

Prudence:

7. **Gross borrowing and the Capital Financing Requirement (estimated borrowing liability excluding PFI)**

Original 2017-18 Capital Financing Requirement (CFR) £m	2017-18 CFR (as at 31 March 2018) £m	Actual Gross Borrowing £m	Difference between actual borrowing and original CFR £m	Difference between actual borrowing and March CFR £m
674.4	752.0	497.9	176.5	254.2

Capital Expenditure

8. **Estimates of capital expenditure**

For details of capital expenditure and funding please refer to the capital outturn report.

External Debt

9. **Authorised limit for external debt**

2017-18 Authorised Limit per TMSS 2017 £m	2017-18 Authorised Limit Restated per TMSS 2018 £m	Actual Borrowing £m	Headroom compared to Restated Authorised Limit £m
733.4	929.3	497.9	431.4

The Authorised limit is the statutory limit on the Council's level of debt and must not be breached. This is the absolute maximum amount of debt the Council may have in the year.

10. **Operational boundary for external debt**

2017-18 Operational Boundary per TMSS 2017 £m	2017-18 Operational Boundary Restated per TMSS 2018 £m	Actual Borrowing £m	Headroom compared to Restated Operational Boundary £m
703.40	899.3	497.9	401.4

The operational boundary is set as a warning signal that debt has reached a level nearing the Authorised limit and must be monitored carefully.