BABERGH and MID SUFFOLK DISTRICT COUNCILS

COMMITTEE: **Joint Audit and Standards Committee**	**REPORT NUMBER:** **JAC/18/3**
FROM: **Katherine Steel, Assistant Director, Corporate Resources**	**DATE OF MEETING:** **30 July 2018**
OFFICERS: **Melissa Evans, Corporate Manager - Finance** **Sue Palmer, Senior Financial Services Officer**	

JOINT ANNUAL TREASURY MANAGEMENT REPORT - 2017/18

1. PURPOSE OF REPORT

1.1 The report is part of the Councils' management and governance arrangements for Treasury Management activity under the CIPFA Code of Practice on Treasury Management ("the Code"). It provides Members with a comprehensive assessment of activities for the year.

1.2 The report specifically sets out the performance of the treasury management function, the effects of the decisions taken, and the transactions executed in the past year and any circumstances of non-compliance with the Councils' treasury management policy statement and treasury management practices.

1.3 The report also includes performance on Prudential Indicators which were set in the 2017/18 Treasury Management Strategy.

1.4 The figures contained in this report are subject to the external auditor's review which will conclude at the end of this month.

2. OPTIONS CONSIDERED

2.1 This report fulfils the Councils' legal obligations to have regard to the Code and there are no options to consider.

3. RECOMMENDATIONS

3.1 That the Treasury Management activity for the year 2017/18 be noted. Further, that it be noted that performance was in line with the Prudential Indicators set for 2017/18.

3.2 That Babergh District Council Treasury Management activity for 2017/18 was in accordance with the approved Treasury Management Strategy, and that, except for one occasion when the Council exceeded its daily bank account limit with Lloyds by £120k, as mentioned in Paragraph 4.6, the Council has complied with all the Treasury Management Indicators for this period be recommended to Council for noting.

3.3	That Mid Suffolk District Council Treasury Management activity for 2017/18 was in accordance with the approved Treasury Management Strategy, and that, except for one occasion when the Council exceeded their daily bank account limit with Lloyds by £79k, as mentioned in Paragraph 4.7, the Council has complied with all the Treasury Management Indicators for this period be recommended to Council for noting.
3.4	The Committee is asked to make a recommendation to Full Council on the above matters.
	REASON FOR DECISION For Members to recommend to full Council.

4. KEY INFORMATION

4.1 The 2017/18 Treasury Management Strategy for both Councils was approved in February 2017.

4.2 The strategy and activities are affected by a number of factors, including the regulatory framework, economic conditions, best practice and interest rate/liquidity risk. The attached appendices summarise the regulatory framework, economic background and information on key activities for the year.

4.3 The following key points for the year are as follows:

- Interest rates continued at very low levels
- The UK economy showed signs of slowing with latest estimates showing GDP, helped by an improving global economy, grew by 1.4% in the calendar year 2017, compared with 1.6% in 2016.
- No new long term external borrowing was taken out by Babergh or Mid Suffolk to finance the 2017/18 capital programme. All the existing long-term debt relates to the HRA for both Councils.
- Babergh increased its short term borrowing by £6m. Mid Suffolk increased its short term borrowing by £6.5m and reduced its long term borrowing by £0.8m (see Appendix B, Table 3).
- Investment activity was undertaken in accordance with the approved counterparty policy and investment limits (see Appendix C, Table 8)

4.4 Specific highlights relating to 2017/18 activity are provided below:

Area/Activity	Babergh	Mid Suffolk	Comments
Long Term Borrowing – average interest rate	3.28%	3.6%	All HRA and fixed rate
Credit Risk Scores during the year (value weighted average)	4.81 – 6.21	4.63– 6.29	Both within the score for the approved A- credit rating for investment counterparties
Compliance with Prudential Indicators	✓	✓	See Appendix D

4.5 There was one breach of the strategy for each Council during the year as follows:

4.6 Babergh District Council Treasury Management activity for 2017/18 was in accordance with the approved Treasury Management Strategy except for one occasion on 2 June 2017 when the Council exceeded its daily bank account limit with Lloyds by £120k, as mentioned in Appendix C Paragraphs 4.5 and 4.6.

4.7 Mid Suffolk District Council Treasury Management activity for 2017/18 was in accordance with the approved Treasury Management Strategy except for one occasion on 2 January 2018 when the Council exceeded its daily bank account limit with Lloyds by £79k, as mentioned in Appendix C Paragraphs 4.5 and 4.6.

5. LINKS TO THE JOINT STRATEGIC PLAN

5.1 Ensuring that the Council has the resources available underpins the ability to achieve the priorities set out in the Joint Strategic Plan.

6. FINANCIAL IMPLICATIONS

6.1 As detailed in the report and appendices.

7. LEGAL IMPLICATIONS

7.1 There are no legal implications arising from this report.

8. RISK MANAGEMENT

8.1 This report is linked to the Councils' Significant Risk Register risk 5(e) "If we do not understand our financial position and respond in a timely and effective way, then we will be unable to deliver the entirety of the Joint Strategic Plan".

8.2 The key risks are set out below:

Risk Description	Likelihood	Impact	Mitigation Measures
If the Councils lose the investment this will impact on their ability to deliver services.	Highly Unlikely (1)	Bad (3)	Strict lending criteria for high credit rated institutions.
If the Councils receive a poor return on investments, there will be fewer resources available to deliver services.	Highly Probable (4)	Noticeable (2)	Focus is on security and liquidity, therefore, careful cashflow management in accordance with the TM Strategy is undertaken throughout the year.
If the Councils have liquidity problems, they will be unable to meet their short-term liabilities.	Unlikely (2)	Noticeable (2)	As above.
If the Councils incur higher than expected borrowing costs, there will be fewer resources available to deliver services.	Unlikely (2)	Noticeable (2)	Benchmark is to borrow from the Public Works Loan Board whose rates are very low and can be on a fixed or variable basis. Research lowest rates available within borrowing boundaries and use other sources of funding and internal surplus funds temporarily.

9. CONSULTATIONS

9.1 None, although it should be noted that Babergh and Mid Suffolk have regular joint strategy meetings with the external treasury advisor, Arlingclose, who provide updates and advice on treasury management issues as they arise.

10. EQUALITY ANALYSIS

10.1 An equality analysis has not been completed because the report content does not have any impact on the protected characteristics.

11. ENVIRONMENTAL IMPLICATIONS

11.1 None directly related to this report.

12. APPENDICES

Title		Location
A	Regulatory Framework, External and Local Context	Attached
B	Borrowing activity	Attached
C	Investment activity	Attached
D	Prudential Indicators	Attached
E	Glossary of Terms	Attached

13. BACKGROUND DOCUMENTS

13.1 CIPFA's Code of Practice on Treasury Management ("the Code").

13.2 Joint Treasury Management Strategy 2017/18 (Paper JAC93).

Appendix A

1. Regulatory Framework

1.1. In February 2012 the Councils adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code) which requires the Councils to approve a treasury management annual report after the end of each financial year.

1.2. This report fulfils the Councils' legal obligation to have regard to the CIPFA Code.

1.3. The Councils' treasury management strategy for 2017/18 was approved at meetings on 21 February 2017 (Babergh) and 23 February 2017 (Mid Suffolk) The Councils have borrowed and invested substantial sums of money and are therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Councils' treasury management strategy.

2. External Context

2.1. Economic background:

2.1.1. 2017/18 was characterised by the push-pull from expectations of tapering of Quantitative Easing (QE) and the potential for increased policy rates in the US and Europe and from geopolitical tensions, which also had an impact.

2.1.2. The UK economy showed signs of slowing with latest estimates showing GDP, helped by an improving global economy, grew by 1.4% in the calendar year 2017, compared with 1.6% in 2016. This was a far better outcome than the majority of forecasts following the EU Referendum in June 2016, but it also reflected the international growth momentum generated by the increasingly buoyant US economy and the re-emergence of the Eurozone economies.

2.1.3. The inflationary impact of rising import prices, a consequence of the fall in sterling associated with the EU referendum result, resulted in year-on-year CPI rising to 3.1% in November 2017 before falling back to 2.7% in February 2018. Consumers felt the squeeze as real average earnings growth, i.e. after inflation, turned negative before slowly recovering. The labour market showed resilience as the unemployment rate fell back to 4.2% in March 2018. The inherent weakness in UK business investment was not helped by political uncertainty following the surprise General Election in June and by the lack of clarity on Brexit, the UK and the EU only reaching an agreement in March 2018 on a transition which will now span Q2 of 2019 to Q4 of 2020. The Withdrawal Treaty has received royal assent in the UK but is yet to be ratified by the other 27 EU member states and new international trading arrangements are yet to be negotiated and agreed.

2.1.4. The Bank of England's Monetary Policy Committee (MPC) increased Bank Rate by 0.25% in November 2017. It was significant in that it was the first rate increase in ten years, although in essence the MPC reversed its August 2016 cut following the referendum result. The February *Inflation Report* indicated the MPC was keen to return inflation to the 2% target over a more conventional (18-24 month) horizon with 'gradual' and 'limited' policy tightening. In June 2018 three MPC members voted to increase policy rates immediately but the MPC itself stopped short of committing itself to the timing of the next increase in rates, saying that any future increases will be at a gradual pace and to a limited extent. It seems likely that there will be an increase in 2018.

2.1.5. In contrast, economic activity in the Eurozone gained momentum and although the European Central Bank removed reference to an 'easing bias' in its market communications and has yet to confirm its QE intention when asset purchases end in September 2018, the Central Bank appeared some way off normalising interest rates. The US economy grew steadily and, with its policy objectives of price stability and maximising employment remaining on track, the Federal Reserve Open Market Committee (FOMC) increased interest rates in December 2017 by 0.25% and again in March, raising the policy rate target range to 1.50% - 1.75%. The Federal Reserve is expected to deliver two more increases in 2018 and a further two in 2019. However, the imposition of tariffs on a broadening range of goods initiated by the US, which has led to retaliation by China, could escalate into a deep-rooted trade war having broader economic consequences including inflation rising rapidly, warranting more interest rate hikes.

2.2. **Financial markets:**

2.2.1. The increase in Bank Rate resulted in higher money markets rates: 1-month, 3-month and 12-month LIBID rates averaged 0.32%, 0.39% and 0.69% and at 31 March 2018 were 0.43%, 0.72% and 1.12% respectively.

2.2.2. Gilt yields displayed significant volatility over the twelve-month period with the change in sentiment in the Bank of England's outlook for interest rates. The yield on the 5-year gilts which had fallen to 0.35% in mid-June rose to 1.65% by the end of March. 10-year gilt yields also rose from their lows of 0.93% in June to 1.65% by mid-February before falling back to 1.35% at year-end. 20-year gilt yields followed an even more erratic path with lows of 1.62% in June, and highs of 2.03% in February, only to plummet back down to 1.70% by the end of the financial year.

2.2.3. The FTSE 100 had a strong finish to the calendar year 2017, reaching yet another record high of 7688, before plummeting below 7000 at the beginning of 2018 in the global equity correction and sell-off.

2.3. **Credit background:**

2.3.1. In the first quarter of the financial year, UK bank credit default swaps reached three-year lows on the announcement that the Funding for Lending Scheme, which gave banks access to cheaper funding, was being extended to 2018. For the rest of the year, CDS prices remained broadly flat.

2.3.2. The rules for UK banks' ring-fencing were finalised by the Prudential Regulation Authority and banks began the complex implementation process ahead of the statutory deadline of 1 January 2019. As there was some uncertainty surrounding which banking entities the Authority would be dealing with once ring-fencing was implemented and what the balance sheets of the ring-fenced and non-ring-fenced entities would actually look like, in May 2017 Arlingclose advised adjusting downwards the maturity limit for unsecured investments to a maximum of 6 months. The rating agencies had slightly varying views on the creditworthiness of the restructured entities.

2.3.3. Barclays was the first to complete its ring-fence restructure over the 2018 Easter weekend; wholesale deposits including local authority deposits will henceforth be accepted by Barclays Bank plc (branded Barclays International), which is the non-ring-fenced bank.

2.3.4. The new EU regulations for Money Market Funds (MMFs) were finally approved and published in July and existing funds will have to be compliant by no later than 21January 2019. The key features include Low Volatility Net Asset Value (LVNAV) Money Market Funds which will be permitted to maintain a constant dealing NAV, providing they meet strict new criteria and minimum liquidity requirements. MMFs will not be prohibited from having an external fund rating (as had been suggested in draft regulations). Arlingclose expects most of the short-term MMFs it recommends converting to the LVNAV structure and awaits confirmation from each fund.

2.4. **Credit Rating developments**

2.4.1. The most significant change was the downgrade by Moody's to the UK sovereign rating in September from Aa1 to Aa2 which resulted in subsequent downgrades to sub-sovereign entities including local authorities.

2.4.2. Changes to credit ratings included Moody's downgrade of Standard Chartered Bank's long-term rating to A1 from Aa3 and the placing of UK banks' long-term ratings on review to reflect the impending ring-fencing of retail activity from investment banking (Barclays, HSBC and RBS were on review for downgrade; Lloyds Bank, Bank of Scotland and National Westminster Bank were placed on review for upgrade).

2.4.3. Standard & Poor's (S&P) revised upwards the outlook of various UK banks and building societies to positive or stable and simultaneously affirmed their long and short-term ratings, reflecting the institutions' resilience, progress in meeting regulatory capital requirements and being better positioned to deal with uncertainties and potential turbulence in the run-up to the UK's exit from the EU in March 2019. The agency upgraded Barclays Bank's long-term rating to A from A- after the bank announced its plans for its entities post ring-fencing.

2.4.4. Fitch revised the outlook on Nationwide Building Society to negative and later downgraded the institution's long-term ratings due to its reducing buffer of junior debt. S&P revised the society's outlook from positive to stable.

3. Local Authority Regulatory Changes

3.1. Revised CIPFA Codes

3.1.1. CIPFA published revised editions of the Treasury Management and Prudential Codes in December 2017. The required changes from the 2011 Code will be incorporated into the forthcoming Treasury Management Strategies and monitoring reports.

3.1.2. The 2017 Prudential Code introduces the requirement for a Capital Strategy which provides a high-level overview of the long-term context of capital expenditure and investment decisions and their associated risks and rewards along with an overview of how risk is managed for future financial sustainability. The Code also expands on the process and governance issues of capital expenditure and investment decisions.

3.1.3. Both Councils will produce a Capital Strategy alongside the Treasury Management Strategy.

3.1.4. In the 2017 Treasury Management Code the definition of 'investments' has been widened to include financial assets as well as non-financial assets held primarily for financial returns such as investment property. These, along with other investments made for non-treasury management purposes such as loans supporting service outcomes and investments in subsidiaries, must be discussed in the Capital Strategy or Investment Strategy. Additional risks of such investments are to be set out clearly and the impact on financial sustainability is be identified and reported.

3.2. MHCLG Investment Guidance and Minimum Revenue Provision (MRP)

3.2.1. In February 2018 the Ministry of Housing, Communities and Local Government (MHCLG) published revised Guidance on Local Government and Investments and Statutory Guidance on Minimum Revenue Provision (MRP).

3.2.2. Changes to the Investment Guidance include a wider definition of investments to include non-financial assets held primarily for generating income returns and a new category called "loans" (e.g. temporary transfer of cash to a third party, joint venture, subsidiary or associate). The Guidance introduces the concept of proportionality, proposes additional disclosure for borrowing solely to invest and specifies additional indicators. Investment strategies must detail the extent to which service delivery objectives are reliant on investment income and a contingency plan should yields on investments fall.

3.2.3. The definition of prudent MRP has been changed to "put aside revenue over time to cover the Capital Financing Requirement" (CFR); it cannot be a negative charge and can only be zero if the CFR is nil or negative. Guidance on asset lives has been updated, applying to any calculation using asset lives. Any change in MRP policy cannot create an overpayment. The new policy must be applied to the outstanding CFR going forward only.

3.3. **MiFID II**

3.3.1. As a result of the second Markets in Financial Instruments Directive (MiFID II), from 3 January 2018 local authorities were automatically treated as retail clients but could "opt up" to professional client status, providing certain criteria were met which includes having an investment balance of at least £10m and the person(s) authorised to make investment decisions on behalf of the Council have at least a year's relevant professional experience. In addition, the regulated financial services firms to whom this directive applies have had to assess that that person(s) have the expertise, experience and knowledge to make investment decisions and understand the risks involved.

3.3.2. Both Councils have met the conditions to opt up to professional status and have done so in order to maintain their erstwhile MiFID II status prior to January 2018. The Councils will continue to have access to products including money market funds, pooled funds, treasury bills, bonds, shares and to financial advice.

4. Local Context

4.1. On 31 March 2018, Babergh had net borrowing of £96.471m and Mid Suffolk had net borrowing of £110.309m arising from the revenue and capital income and expenditure activities. This is an increase of £19.732m for Babergh and £14.074m for Mid Suffolk from the 31 March 2017 position. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors and the year-on-year change are summarised in Table 1 below.

4.2. **Table 1: Borrowing Summary**

Babergh	**31.3.17 Actual £m**	**2017/18 Movement £m**	**31.3.18 Actual £m**
General Fund CFR	18.609	12.577	31.186
HRA CFR	86.253	(0.500)	85.753
Total CFR	**104.862**	**12.077**	**116.939**
Less: Usable reserves	(22.254)	(2.795)	(25.049)
Add / (Less): Working Capital	(5.869)	10.450	4.581
Net Borrowing	**76.739**	**19.732**	**96.471**

Mid Suffolk	**31.3.17 Actual £m**	**2017/18 Movement £m**	**31.3.18 Actual £m**
General Fund CFR	22.241	13.592	35.833
HRA CFR	86.759	0.000	86.759
Total CFR	**109.000**	**13.592**	**122.592**
Less: Usable reserves	(22.723)	(6.660)	(29.383)
Add: Working Capital	9.958	7.142	17.100
Net Borrowing	**96.235**	**14.074**	**110.309**

4.3. Both Councils' net borrowing has increased due to a rise in the CFR as new capital expenditure was higher than the financing applied, including minimum revenue provision. This was offset by an increase in usable reserves and a decrease in working capital due to the timing of receipts and payments and an increase in short term borrowing.

4.4. The current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing, to reduce risk and keep interest costs low.

4.5. **Table 2: Treasury Management Summary**

4.6. The treasury management position as at 31 March 2018 and the year-on-year change is shown in Table 2 below.

Babergh	**31.3.17 Balance £m**	**2017/18 Movement £m**	**31.3.18 Balance £m**	**31.3.18 Rate %**
Long-term borrowing	86.797	(0.500)	86.297	3.29%
Short-term borrowing	6.000	6.000	12.000	0.68%
Total borrowing	**92.797**	**5.500**	**98.297**	
Long-term investments	9.638	0.000	9.638	4.96%
Short-term investments	2.000	(2.000)	0.000	0.17%
Cash and Cash equivalents	4.039	(1.594)	2.445	0.22%
Total investments	**15.677**	**(3.594)**	**12.083**	
Net Borrowing	**77.120**	**9.094**	**86.214**	

Mid Suffolk	**31.3.17 Balance £m**	**2017/18 Movement £m**	**31.3.18 Balance £m**	**31.3.18 Rate %**
Long-term borrowing	74.887	(0.800)	74.087	3.88%
Short-term borrowing	22.500	6.500	29.000	0.79%
Total borrowing	**97.387**	**5.700**	**103.087**	
Long-term investments	9.642	0.000	9.642	4.94%
Short-term investments	2.000	(2.000)	0.000	0.15%
Cash and Cash equivalents	3.872	(1.478)	2.394	0.25%
Total investments	**15.514**	**(3.478)**	**12.036**	
Net Borrowing	**81.873**	**9.178**	**91.051**	

4.7. The figures in Table 2 are from the balance sheet in the statement of accounts, adjusted to exclude operational cash, accrued interest and other accounting adjustments.

4.8. Babergh and Mid Suffolk have both increased net borrowing to finance capital expenditure.

Appendix B

1. Borrowing Activity

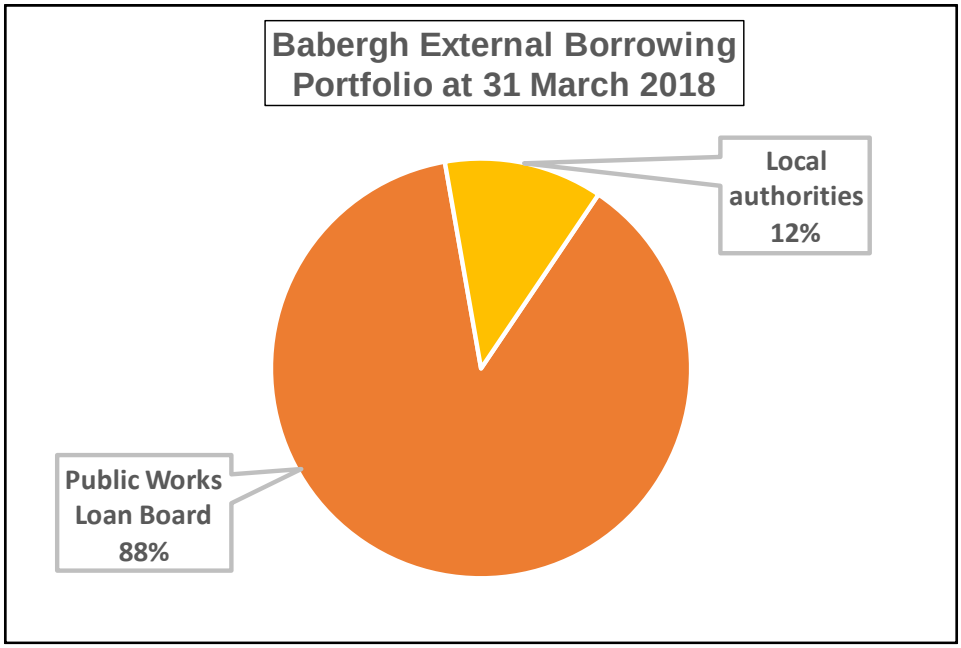
1.1. At 31 March 2018, Babergh held £98.297m of loans an increase of £5.5m on the previous year. Mid Suffolk held £103.087m of loans and increase of £5.7m on the previous year. These increases are part of both councils' strategy for funding previous years' capital programmes. The year-end borrowing position and the year-on-year change in show in Table 3 below.

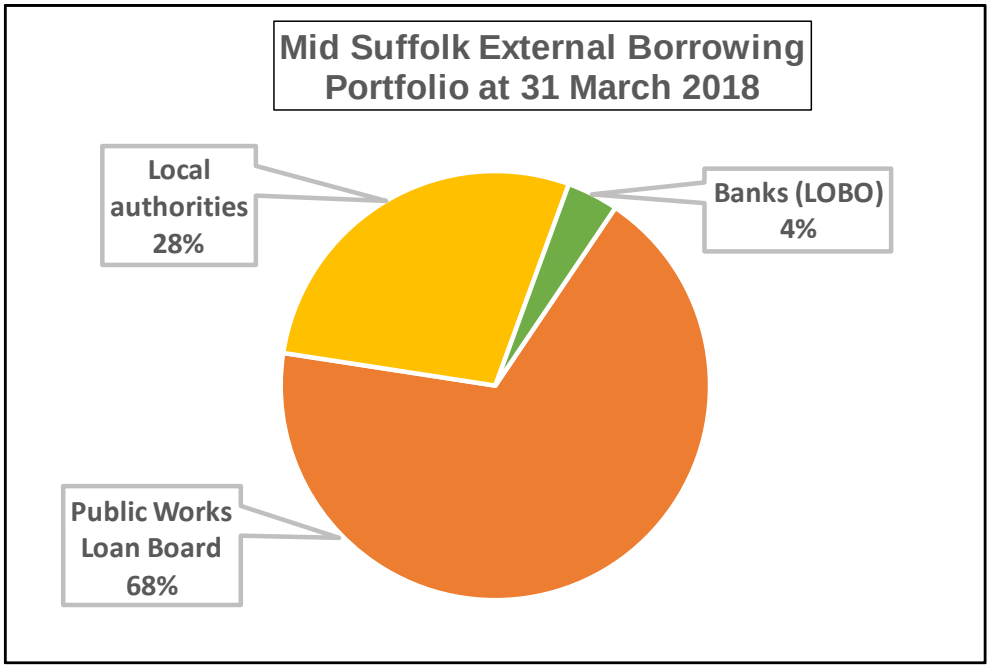
1.2. **Table 3: Borrowing Position**

Babergh	**31.3.17 Balance £m**	**2017/18 Movement £m**	**31.3.18 Balance £m**	**31.3.18 Average Rate %**
Public Works Loan Board	86.797	(0.500)	86.297	3.29%
Local authorities (short-term)	6.000	6.000	12.000	0.68%
Total borrowing	**92.797**	**5.500**	**98.297**	

Mid Suffolk	**31.3.17 Balance £m**	**2017/18 Movement £m**	**31.3.18 Balance £m**	**31.3.18 Average Rate %**
Public Works Loan Board	70.887	(0.800)	70.087	3.55%
Banks (LOBO)	4.000	0.000	4.000	4.21%
Local authorities (short-term)	22.500	6.500	29.000	0.79%
Total borrowing	**97.387**	**5.700**	**103.087**	

1.3. **Table 3 - Charts: Borrowing Position**





1.4. The Councils' objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Councils' long-term plans change being a secondary objective.

1.5. All new loans for Babergh and Mid Suffolk were taken as short term local authority borrowing to take advantage of low interest rates in 2017/18. This strategy enabled the Councils to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The "cost of carry" analysis performed by the Councils' treasury management advisor Arlingclose did not indicate any value in borrowing in advance for future years' planned expenditure and therefore none was taken.

1.6. Mid Suffolk continues to hold £4m of LOBO loans (Lender's Option Borrower's Option) where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. The banks did not exercise their option during 2017/18.

Appendix C

1. Investment Activity

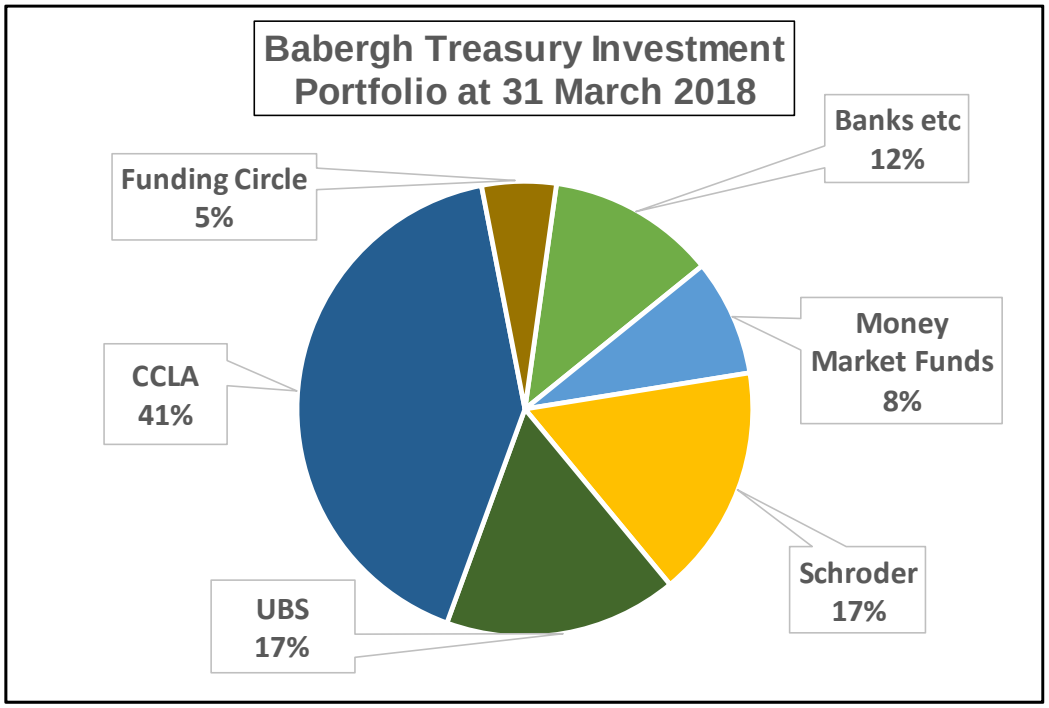
1.1. Babergh and Mid Suffolk hold invested funds, representing income received in advance of expenditure plus balances and reserves. During 2017/18, Babergh's Investment balance ranged between £11.667m and £23.335m. Mid Suffolk's investment balance ranged between £11.089m and £22.709m. These movements are due to timing differences between income and expenditure. The year-end investment position and the year-on-year change are shown in Table 4 below.

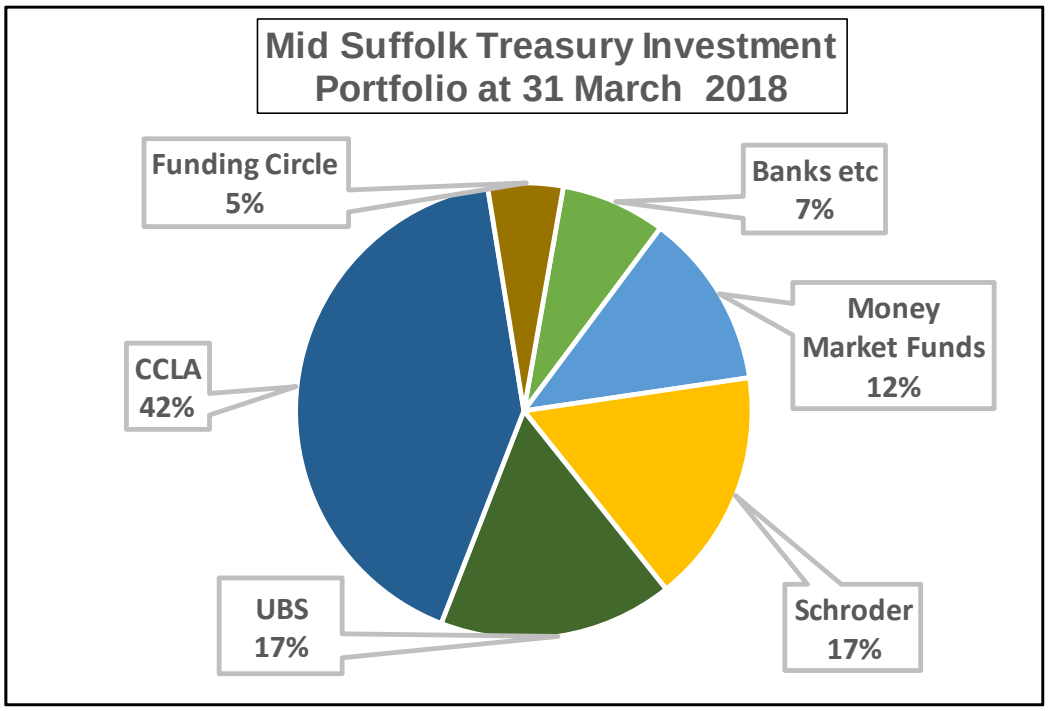
1.2. **Table 4: Investment Position**

Babergh	**31.3.17 Balance £m**	**2017/18 Movement £m**	**31.3.18 Balance £m**	**31.3.18 Average Rate %**
Banks & building societies (unsecured)	1.339	0.106	1.445	0.15%
Government (incl. local authorities)	2.000	(2.000)	0.000	0.17%
Money Market Funds	2.700	(1.700)	1.000	0.24%
Schroder	2.000	0.000	2.000	6.86%
UBS	2.000	0.000	2.000	3.74%
CCLA	5.000	0.000	5.000	4.54%
Funding Circle	0.638	0.000	0.638	4.54%
Total investments	**15.677**	**(3.594)**	**12.083**	

Mid Suffolk	**31.3.17 Balance £m**	**2017/18 Movement £m**	**31.3.18 Balance £m**	**31.3.18 Average Rate %**
Banks & building societies (unsecured)	0.572	0.322	0.894	0.15%
Government (incl. local authorities)	2.000	(2.000)	0.000	0.15%
Money Market Funds	3.300	(1.800)	1.500	0.28%
Schroder	2.000	0.000	2.000	6.86%
UBS	2.000	0.000	2.000	3.73%
CCLA	5.000	0.000	5.000	4.47%
Funding Circle	0.642	0.000	0.642	4.63%
Total investments	**15.514**	**(3.478)**	**12.036**	

1.3. **Table 4 - Charts: Investment Position**





1.4. Both the CIPFA Code and government guidance requires Councils to invest their funds prudently, and to have regard to the security and liquidity of investments before seeking the highest rate of return, or yield. The Councils' objectives when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

1.5. Babergh and Mid Suffolk have both followed the treasury strategy to move investments into long term pooled funds. No new investments were made in these during 2017/18. They have generated higher returns for the Councils in a period when interest rates are falling. The remaining investments are short term and highly liquid to ensure both Councils can meet their liabilities.

1.6. As a result, Credit Scores and Bail-in Exposure has increased for both Councils. Bail-in exposure is the percentage of our investments that could be lost if banks were to fail, while the average rate of return has increased from 3.69% to 5.10% for Babergh and from 3.50% to 5.08% for Mid Suffolk respectively. The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in Table 5 below.

1.7. **Table 5: Investment Benchmarking**

Babergh	Credit Score	Credit Rating	Bail-in Exposure	Rate of Return
31.03.2017	4.81	A+	61%	3.69%
30.06.2017	5.53	A	88%	4.78%
30.09.2017	5.29	A+	90%	4.69%
31.12.2017	5.37	A+	94%	4.35%
31.03.2018	6.21	A	85%	5.10%
Similar LAs	**4.22**	**AA-**	**53%**	**1.32%**
All Las	**4.24**	**AA-**	**55%**	**1.08%**

Mid Suffolk	Credit Score	Credit Rating	Bail-in Exposure	Rate of Return
31.03.2017	4.63	A+	59%	3.50%
30.06.2017	5.29	A+	88%	4.87%
30.09.2017	5.25	A+	90%	4.93%
31.12.2017	6.29	A	83%	6.17%
31.03.2018	5.85	A	85%	5.08%
Similar LAs	**4.22**	**AA-**	**53%**	**1.32%**
All Las	**4.24**	**AA-**	**55%**	**1.08%**

1.8. Both Councils' Bail-in Exposure is above the Similar and All Local Authority averages because the investments are mainly in unsecured deposits (e.g. pooled funds and money market funds). These are generally higher risk with higher expected returns.

1.9. Babergh's best performing investments in 2017/18 were its £9.6m of externally managed pooled equity, property and multi asset funds. These generated an average total return on investment of 4.99%.

1.10. Mid Suffolk's best performing investments in 2017/18 were its £9.6m of externally managed pooled equity, property and multi asset funds. These generated an average total return on investment of 4.97%.

1.11. These funds have no defined maturity date but are available for withdrawal after a notice period. Their performance and continued suitability in meeting the Councils' investment objectives is regularly reviewed. In light of their strong performance and the latest cash flow forecasts, investment in these funds has been maintained for the 2018/19 financial year.

2 Other Non-Treasury Holdings and Investment Activity

2.1 Investment Property

2.1.1 During 2016/17 Babergh District Council purchased Borehamgate Shopping Centre in Sudbury for £3.56m. This has been classified as an investment property and on 31 March 2018, the District Valuer assessed its Fair Value at £4m. Net Income, after the deduction of direct costs, was £260k in 2017/18 (£143k in 2016/17).

2.2 Trading Companies

2.2.1 Following approval by both Full Councils in April 2017 to set up a holding company for each Council, activity to invest £50m for capital investment began with their first purchase in December 2017. During 2017/18 a total of £24.6m of the £50m has been spent, with the remainder expected to be invested by December 2018.

2.2.2 Interest receivable by the Councils during the year was £173k, in total, for both Councils.

3 Performance Report

3.1 The Councils measure the financial performance of treasury management activities in terms of their impact on the General Fund and HRA budgets as shown in Table 6 below.

3.2 Table 6 Treasury Activity - Performance

Babergh	2017/18 Actual £m	2017/18 Budget £m	2017/18 Adverse/ (Favourable) £m	2017/18 Actuals Compared to budget %	2017/18 Adverse / (Favourable) Budget %
Interest receivable	(0.551)	(0.433)	(0.118)	127.25	0.273
GF Interest Payable	0.011	0.008	0.003	137.50	0.375
HRA Interest Payable	2.844	2.803	0.041	101.46	0.015

Mid Suffolk	2017/18 Actual £m	2017/18 Budget £m	2017/18 Adverse/ (Favourable) £m	2017/18 Actuals Compared to budget %	2017/18 Adverse / (Favourable) Budget %
Interest receivable	(0.535)	(0.381)	(0.154)	140.42	0.404
GF Interest Payable	0.043	0.083	(0.040)	51.81	(0.482)
HRA Interest Payable	2.704	3.042	(0.338)	88.89	(0.111)

3.3 The interest receivable income for both Babergh and Mid Suffolk were above budget by £118k and £154k respectively. This is due to the higher than expected returns from long term pooled funds in the CCLA, UBS, Funding Circle and Schroder Income Maximiser Fund.

3.4 The short-term interest payable for the year was under budget by £40k for Mid Suffolk. The budgets for the PWLB interest payable (HRA only) were slightly understated for Babergh and overstated for Mid Suffolk. These have been reviewed for 2018/19.

3.5 **Long term investment returns**

3.5.1 Babergh and Mid Suffolk have both invested in long term pooled funds. Below are details of how these investments have performed from the date of the initial investment to 31 March 2018.

CCLA	**Babergh £**	**Mid Suffolk £**
Amount Invested	5,000,000	5,000,000
Investment Valued at 31 March 2018	4,927,415	4,851,201
Interest received from date of initial investment	658,404	605,239
Management Expenses Paid	(76,996)	(71,041)
Net Interest received from date of initial investment	**581,407**	**534,198**
Net Interest received 2017/18	**227,028**	**223,516**
Rate of Return 2017/18	**4.54%**	**4.47%**

3.5.2 Babergh and Mid Suffolk both invested into the Schroder Income maximiser fund on 10 February 2017.

Schroder Maximiser Fund	**Babergh £**	**Mid Suffolk £**
Amount Invested	2,000,000	2,000,000
Investment Valued at 31 March 2018	1,926,959	1,926,959
Net Interest received	**137,129**	**137,129**
Rate of Return 2017/18	**6.86%**	**6.86%**

3.5.3 Babergh District Council invested into the UBS on 26 November 2015, whilst Mid Suffolk invested into the fund on 28 March 2017.

UBS	**Babergh £**	**Mid Suffolk £**
Amount Invested	2,000,000	2,000,000
Investment Valued at 31 March 2018	1,923,289	1,919,890
Net Interest received from date of initial investment	**192,368**	**96,210**
Net Interest received 2017/18	**74,744**	**74,612**
Rate of Return 2017/18	**3.74%**	**3.73%**

3.5.4

Funding Circle	Babergh £	Mid Suffolk £
Amount Invested - National	613,000	617,000
Amount Invested - Local	25,000	25,000
Total Amount Invested	638,000	642,000
Bad debts	(15,540)	(16,357)
Net Investments	**622,460**	**625,643**
Income received	70,855	74,643
Cash back	20	20
Servicing costs	(8,332)	(8,823)
Net Income received from date of initial investment	**62,543**	**65,840**
Invested but still Unallocated - National	165,834	178,360
Invested but still Unallocated - Local	24,166	24,166
Net Interest received 2017/18	28,996	29,703
Rate of Return 2017/18	**4.54%**	**4.63%**

4. Compliance Report

4.1. The Section 151 Officer is pleased to report that all treasury management activities undertaken during 2017/18 complied fully with the CIPFA Code of Practice and the Councils' approved Treasury Management Strategy.

4.2. Compliance with the authorised limit and operational boundary for external debt is demonstrated in Table 7 below.

4.3. **Table 7: Debt Limits**

Total Borrowing	2017/18 Maximum £m	31.3.18 Actual £m	2017/18 Operational Boundary	2017/18 Authorised Limit	Complied
Babergh	98.297	98.297	123.000	126.000	✓
Mid Suffolk	103.090	103.087	127.000	146.000	✓

4.4. Since the operational boundary is a management tool for in-year monitoring, it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure.

4.5. **Table 8: Investment Limits**

Compliance with specific investment limits is demonstrated in Table 8 as follows.

Babergh	**2017/18 Maximum**	**31.3.18 Actual**	**2017/18 Limit**	**Complied**
Any single organisation, except the UK Central Government	£2.120m	£1.445m	£2m	x
Any group of organisations under the same ownership	£0m	£0m	£1m	✓
Any group of pooled funds under the same management	£5m	£5m	£5m	✓
Negotiable instruments held in a broker's nominee account	£0m	£0m	£10m	✓
Foreign countries	£0m	£0m	£2m	✓
Registered Providers	£0m	£0m	£5m	✓
Unsecured investments with Building Societies	£0m	£0m	£2m	✓
Loans to unrated corporates	£0.638m	£0.638m	£1m	✓
Money Market Funds	£2m	£2m	£2m	✓

Mid Suffolk	**2017/18 Maximum**	**31.3.18 Actual**	**2017/18 Limit**	**Complied**
Any single organisation, except the UK Central Government	£1.079m	£0.894m	£1m	x
Any group of organisations under the same ownership	£0m	£0m	£1m	✓
Any group of pooled funds under the same management	£5m	£5m	£5m	✓
Negotiable instruments held in a broker's nominee account	£0m	£0m	£10m	✓
Foreign countries	£1m	£1m	£2m	✓
Registered Providers	£0m	£0m	£5m	✓
Unsecured investments with Building Societies	£0m	£0m	£2m	✓
Loans to unrated corporates	£0.642m	£0.642m	£1m	✓
Money Market Funds	£2m	£2m	£2m	✓

4.6. It should be noted that both Councils' Treasury Management activity for 2017/18 was in accordance with the approved Treasury Management Strategy, and that, except for one day for both Councils, exceeded their daily bank account limits with Lloyds, (Babergh by £120k and Mid Suffolk by £79k) both Councils have complied with all the Treasury Management Indicators for this period.

5. Treasury Management Indicators

5.1. The Councils measure and manage their exposure to treasury management risks using the following indicators:

5.2. **Security:** Babergh and Mid Suffolk have adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit score of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

5.3. **Table 9: Credit Scores**

Credit Scores	**31.3.18 Actual**	**2017/18 Target**	**Complied**
Babergh Portfolio average Credit Score	6.21	7.00	✓
Mid Suffolk Portfolio average Credit Score	5.85	7.00	✓

5.4. **Interest Rate Exposures**: This indicator is set to control the Councils' exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of net principal borrowed was:

5.5. **Table 10: Fixed Interest rate exposure**

Fixed Interest rate exposure	31.3.18 Actual £m	2017/18 Limit £m	Complied
Babergh Upper limit on fixed interest rate exposure	86.30	138.00	✓
Babergh Upper limit on variable interest rate exposure	12.00	35.00	✓
Mid Suffolk Upper limit on fixed interest rate exposure	74.09	127.00	✓
Mid Suffolk Upper limit on variable interest rate exposure	29.00	40.00	✓

5.6. Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months measured from the start of the financial year or the transaction date if later. All other instruments are classed as variable rate.

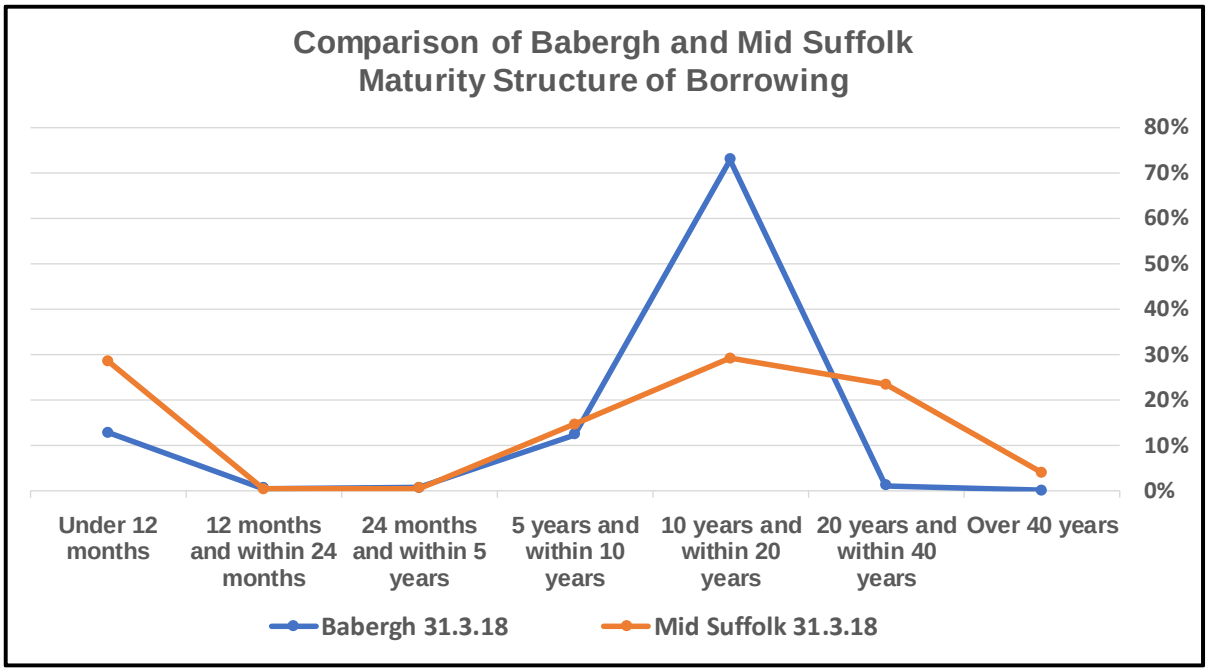
5.7. **Maturity Structure of Borrowing**: This indicator is set to control the Councils' exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing were:

5.8. **Table 11: Maturity Structures**

Age Profile of Maturity	Babergh 31.3.18 Actual	Mid Suffolk 31.3.18 Actual	Lower Limit	Upper Limit	Complied
Under 12 months	12.72%	28.42%	0%	50%	✓
12 months and within 24 months	0.51%	0.29%	0%	50%	✓
24 months and within 5 years	0.56%	0.44%	0%	50%	✓
5 years and within 10 years	12.21%	14.55%	0%	100%	✓
10 years and within 20 years	72.89%	29.10%	0%	100%	✓
20 years and within 40 years	1.12%	23.32%	0%	100%	✓
Over 40 years	0.00%	3.88%	0%	100%	✓

5.9. Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

5.10. **Table 11 Chart: Maturity Structures**



5.11. **Principal Sums Invested for Periods Longer than 364 days:** The purpose of this indicator is to control the exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:

5.12. **Table 12: Principal Sums**

Babergh	**2017/18**	**2018/19**	**2019/20**
Actual principal invested beyond year end	£0	£0	£0
Limit on principal invested beyond year end	£2m	£2m	£2m
Complied	✓	✓	✓

Mid Suffolk	**2017/18**	**2018/19**	**2019/20**
Actual principal invested beyond year end	£0	£0	£0
Limit on principal invested beyond year end	£2m	£2m	£2m
Complied	✓	✓	✓

5.13. Whilst the investments that have been made in CCLA, UBS, Schroder and Funding Circle are intended to benefit from longer term higher returns, they can be redeemed on a short-term basis.

Appendix D

1. Prudential Indicators

1.1. Introduction

1.1.1. The Local Government Act 2003 requires the councils to have regard to the Chartered Institute of Public Finance and Accountancy's Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that councils have fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

1.1.2. This report compares the approved indicators with the outturn position for 2017/18. Actual figures have been taken from or prepared on a basis consistent with, the Councils' statements of accounts.

1.2. Capital Expenditure

1.2.1. The Councils' capital expenditure and financing may be summarised as follows:

Babergh District Council		
Capital Expenditure and Financing	**2017/18 Estimate £m**	**2017/18 Actual £m**
General Fund	14.450	13.908
HRA	13.046	8.528
Total Expenditure	**27.496**	**22.436**
Capital Receipts	3.754	0.895
Grants and Contributions	0.366	0.563
Revenue Contributions and Reserves	4.405	4.339
Major Repairs Reserve	2.735	3.235
Borrowing	16.236	13.404
Total Financing	**27.496**	**22.436**

Mid Suffolk District Council		
Capital Expenditure and Financing	**2017/18 Estimate £m**	**2017/18 Actual £m**
General Fund	31.873	14.835
HRA	7.751	6.916
Total Expenditure	**39.624**	**21.751**
Capital Receipts	2.002	1.116
Grants and Contributions	0.406	0.733
Revenue Contributions and Reserves	3.074	2.211
Major Repairs Reserve	2.762	3.442
Borrowing	31.380	14.249
Total Financing	**39.624**	**21.751**

2. Prudential Indicator Compliance

2.1. Capital Financing Requirement

2.1.1. The Capital Financing Requirement (CFR) measures the Councils' underlying need to borrow for capital purposes.

Babergh District Council			
Capital Expenditure and Financing	**31.3.18 Estimate £m**	**31.3.18 Actual £m**	**Difference £m**
General Fund	31.564	31.186	(0.378)
HRA	88.119	85.753	(2.366)
Total CFR	**119.683**	**116.939**	**(2.744)**

Mid Suffolk District Council			
Capital Expenditure and Financing	**31.3.18 Estimate £m**	**31.3.18 Actual £m**	**Difference £m**
General Fund	52.964	35.833	(17.131)
HRA	86.759	86.759	0.000
Total CFR	**139.723**	**122.592**	**(17.131)**

2.1.2. As shown in Appendix A Table 1, the CFR increased during the year for Babergh by £12.077m and for Mid Suffolk by £13.592m as capital expenditure financed by debt outweighed resources put aside for debt repayment.

3. Actual Debt

3.1. The Councils' actual debt at 31 March 2018 was as follows:

Total Debt	**31.3.18 Estimate £m**	**31.3.18 Actual £m**	**Difference £m**
Babergh District Council	109.033	98.297	(10.736)
Mid Suffolk District Council	143.763	103.087	(40.676)

4. Gross Debt and the Capital Financing Requirement

4.1. In order to ensure that over the medium-term debt will only be for a capital purpose, the Councils should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence.

Babergh District Council			
Debt and CFR	**31.3.18 Actual £m**	**31.3.19 Estimate £m**	**31.3.20 Estimate £m**
Total Debt	98.297	127.020	133.760
Capital financing requirement	116.939	136.236	141.365
Headroom	**18.642**	**9.216**	**7.605**

Mid Suffolk District Council			
Debt and CFR	**31.3.18 Actual £m**	**31.3.19 Estimate £m**	**31.3.20 Estimate £m**
Total Debt	103.087	143.760	147.100
Capital financing requirement	122.592	154.309	156.238
Headroom	**19.505**	**10.549**	**9.138**

4.2. The total debt remained below the CFR during the forecast period.

5. Operational Boundary for External Debt

5.1. The operational boundary is based on the Councils' estimate of the most likely (i.e. prudent but not worst case) scenario for external debt. It links directly to the Councils' estimates of capital expenditure, the capital financing requirement, and cash flow requirements, and is a key management tool for in-year monitoring.

Operational Boundary and Total Debt	**31.3.18 Boundary £m**	**31.3.18 Actual Debt £m**	**Complied**
Babergh District Council	120.000	98.297	√
Mid Suffolk District Council	140.000	103.087	√

6. Authorised Limit for External Debt

6.1. The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Councils can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

Authorised Limit and Total Debt	31.3.18 Limit £m	31.3.18 Actual Debt £m	Complied
Babergh District Council	130.000	98.297	√
Mid Suffolk District Council	150.000	103.087	√

7. Ratio of Financing Costs to Net Revenue Stream

7.1. This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

Babergh District Council			
Ratio of Financing Costs to Net Revenue Stream	**31.3.18 Estimate %**	**31.3.18 Actual %**	**Difference %**
General Fund	3.03%	2.36%	(0.67)%
HRA	17.79%	17.95%	0.16%

Mid Suffolk District Council			
Ratio of Financing Costs to Net Revenue Stream	**31.3.18 Estimate %**	**31.3.18 Actual %**	**Difference %**
General Fund	0.12%	1.23%	1.11%
HRA	19.28%	19.24%	(0.04)%

8. Adoption of the CIPFA Treasury Management Code

8.1. The Councils adopted the Chartered Institute of Public Finance and Accountancy's "Treasury Management in the Public Services: Code of Practice 2011 Edition" in February 2012.

9. HRA Limit on Indebtedness

9.1. The Councils' HRA CFRs should not exceed the limit imposed by the Ministry for Housing, Communities and Local Government (MHCLG).

HRA CFR	31.3.18 Limit £m	31.3.18 Actual £m	Complied
Babergh District Council	97.849	85.753	√
Mid Suffolk District Council	90.851	86.759	√

Appendix E

Glossary of Terms

CFR	Capital Financing Requirement. The underlying need to borrow to finance capital expenditure.
CIPFA	The Chartered Institute of Public Finance and Accountancy. This is the leading professional accountancy body for public services.
CLG	Department for Communities and Local Government. This is a ministerial department.
CPI	Consumer Price Index. This measures changes in the price level of consumer goods and services purchased by households.
CPIH	Consumer Price Index Housing. A measure of consumer price inflation including a measure of owner occupiers' housing costs (OOH).
CCLA	Churches, Charities and Local Authority Property Fund
DMADF	Debt Management Account Deposit Facility.
Funding Circle	Accounts set up to lend money to local and national businesses at competitive rates
GDP	Gross Domestic Product. This is the market value of all officially recognised goods and services produced within a country in a given period of time.
HRA	Housing Revenue Account. The statutory account to which are charged the revenue costs of providing, maintaining and managing Council dwellings. These costs are financed by tenants' rents.
LIBID	London Interbank Bid Rate. The interest rate at which banks bid to take short-term deposits from other banks in the London interbank market.
LOBO	Lender's Option Borrower's Option. This is a loan where the lender has certain dates when they can increase the interest rate payable and, if they do, the Council has the option of accepting the new rate or repaying the loan.
LVNAV	Low Volatility Net Asset Value. A new type of Low Volatility Net Asset Value Money Market Fund - a new fund category introduced as part of a new regulatory reform of the sector in Europe.
MiFiD	The Markets in Financial Instruments Directive (2014/65/EU) (MiFID II). The EU legislation that regulates firms who provide services to clients linked to 'financial instruments' (shares, bonds, units in collective investment schemes and derivatives), and the venues where those instruments are traded.
MPC	Monetary Policy Committee. A committee of the Bank of England which decides the Bank of England's Base Rate and other aspects of the Government's Monetary Policy.
MRP	Minimum Revenue Provision. Local authorities are required to make a prudent provision for debt redemption on General Fund borrowing
NAV	Net Asset Value. The NAV is the value of a fund's assets less the value of its liabilities on a per unit basis.
PWLB	Public Works Loan Board - offers loans to local authorities below market rates.
QE	Quantitative Easing. The purchase of Government bonds by the Bank of England to boost the money supply.
T Bills	Treasury Bill. A short-term Government Bond.
UBS	UBS Multi Asset Income Fund (UK) – a pooled fund.