Agenda Item

Report

7

Report to:	**Finance and Corporate Resources Committee**
Date of Meeting:	**20 June 2018**
Report by:	**Executive Director (Finance and Corporate Resources)**

Subject:	**Prudential Indicators, Treasury Management Strategy and Annual Investment Strategy 2017/2018**

1. Purpose of Report

1.1. The purpose of the report is to:-

- provide an overview of the Treasury Management Activity and Prudential Code Indicators for 2017/2018
- allow Committee to scrutinise the proposed Annual Investment Report for 2017/2018

2. Recommendation(s)

2.1. The Committee is asked to approve the following recommendation(s):-

(1) that the Treasury Management Activity Report for 2017/2018 (Section 4 and Appendix 1), be noted;

(2) that the 2017/2018 Treasury Management and Prudential Code Indicators (Section 5 and Appendix 2), be noted;

(3) that the Treasury Management Activity Report (Appendix 1) and the Treasury Management and Prudential Indicators (Appendix 2) be referred to the Executive Committee for noting;

(4) that the 2017/2018 Annual Investment Report (Section 6 and appendix 3) be endorsed; and

(5) that the 2017/2018 Annual Investment Report be referred to the Executive Committee prior to submission to the Council for formal approval in line with The Local Government Investments (Scotland) Regulations 2010.

3. Background

3.1. The Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice for Treasury Management requires councils to prepare an annual report on their Treasury Management Activities. The report covering the Council's Treasury Management Activity during 2017/2018 is summarised in Section 4 of the report and provided in detail in Appendix 1.

3.2. The Council's capital programme is partly funded by planned borrowing. The CIPFA Prudential Code provides a framework to assist the management of the financial implications of borrowing and helps to demonstrate that the borrowing is both affordable and prudent. The Code requires councils to prepare a series of financial indicators that demonstrate affordability, prudence and sustainability with regard to capital financing decisions.

3.3. Estimates of these indicators are reported to the Finance and Corporate Resources Committee at the start of each year, with selected indicators then reported on an actual basis at the end of the year. The year end indicators for 2017/2018 are noted in Section 5 of the report and detailed in Appendix 2.

3.4. The Local Government Investments (Scotland) Regulations 2010 require local authorities to prepare an Annual Investment Strategy before the start of the financial year and an Annual Investment Report after the financial year end. Both documents are required to be approved by full Council.

3.5. The Annual Investment Report for 2017/2018 is summarised in Section 6 of this report with the detail in Appendix 3.

3.6. The Annual Investment Strategy for 2017/2018 recognised that any investment activity carries an element of risk. Appendix 4 details the investments that the Council were permitted to use in 2017/2018, the associated risks and the controls and limits that were put in place to mitigate these risks.

3.7. The figures contained within this report are taken or calculated from South Lanarkshire Council's Annual Accounts for 2017/2018. It should be noted that the Annual Accounts have not yet been audited and therefore some of the figures may be subject to change. Significant changes to the indicators resulting from the audit will be reported back to Committee at a later date.

4. Treasury Management Activity 2017/2018

4.1. Appendix 1 details the Treasury Management Activity for 2017/2018. The Council ended the year with debt of £904.164m with fixed rate loans from the Public Works Loans Board (PWLB) making up 98.92% of the debt. Fixed rate loans help to build in certainty to the calculation of future loan charges which forms a significant element of the Council's long term Revenue Budget Strategy.

4.2. The Council's pooled interest rate for 2017/2018 was 3.78% (3.88% in 2016/2017), with an expenses rate of 0.06%. The overall cost of borrowing will increase as debt levels increase to fund the capital programme.

4.3. Total deposits at the end of the year totalled £44.980m with the level varying throughout the year due to the timing of expenditure and receipts.

4.4. During 2017/2018, the Council placed £1,072.754m of deposits on a cumulative basis. All deposits made by the Council were in line with approved lending limits and credit rating criteria. The level of investment return was £0.153m.

5. Treasury Management and Prudential Code Indicators – 2017/2018

5.1. The Council is required by the Prudential Code to report the actual prudential indicators after the closure of the financial year. Appendix 2 details the indicators for 2017/2018.

5.2. The General Fund Capital Expenditure for 2017/2018 was £55.640m, which is £22.651m less than estimated in the Prudential Indicators, Treasury Management Strategy and Annual Investment Strategy report presented to the Executive Committee on 28 February 2018. The details of this have been reported to the Executive Committee over recent months, with a final position being reported on 27 June 2018.

5.3. The Housing Revenue Account (HRA) Capital Expenditure in 2017/2018 was £37.338m which is £3.243m less than the estimate reported to the Executive Committee in February 2018. The details of this have been reported to the Executive Committee over recent months, with a final position being reported on 27 June 2018.

5.4. The Council's gross borrowing position for 2017/2018 was £1,120.302m. This consists of external borrowing of £904.164m and the PPP Finance Lease Liability of £216.138m. Gross borrowing is less than the capital financing requirement of £1,254.719m due to the fact that no borrowing was required to be taken during 2017/2018. The Council used existing cash balances in lieu of borrowing as there was no evidence of interest rates increasing and to borrow before cash was required would incur a cost of carry as the interest rates achievable on deposits continue to be less than the interest rates on borrowing.

5.5. The Capital Financing Requirement, reflecting the need to borrow, for the General Fund is £21.671m lower than forecast and for HRA is £6.078m lower than forecast. In both cases, the reason is mainly due to a reduction in borrowing required to fund the capital programme.

5.6. One indicator covers borrowing and sets limits on the level of borrowing that the Council can have: The Operational Boundary is the expected borrowing position, but it can vary due to changes in the cash flow and temporary breaches are acceptable. In contrast, the Authorised Limit represents the maximum level of debt the Council can afford and should not be breached. The Council remained within both the Operational Boundary and Authorised Limit for gross debt during 2017/2018.

6. Annual Investment Report – 2017/2018

6.1. The Council is required by The Local Government Investments (Scotland) Regulations 2010 to prepare an Annual Investment Report after the financial year end. The Annual Investment Report for financial year 2017/2018 is detailed in Appendix 3 and summarised below.

6.2. During 2017/2018 the Council placed £1,072.754m of deposits on a cumulative basis. All deposits made by the Council were in line with approved lending limits and credit rating criteria. £1,030.352m (96.05%) of deposits were made with counterparties of very high credit quality (UK Government DMO Account, Treasury Bills and other local authorities). The remaining £42.402m (3.95%) was deposited with Bank of Scotland which continues to meet our credit rating criteria.

6.3. In order to manage liquidity risk, the Council held an average of £9.721m in bank accounts with instant access.

6.4. No borrowing in advance was taken during 2017/2018.

7. Employee Implications

7.1 None

8. Financial Implications

8.1. The financial impact from treasury activity and borrowing for capital expenditure has been built into the long term Revenue Budget Strategy.

8.2. In 2017/2018, the amounts charged to the General Fund in relation to debt (loan charges) totalled £52.205m, while the charge to reduce the PPP/Finance Lease Liability was £6.756m. HRA loan charges totalled £14.278m. These costs were met from within revenue budgets.

8.3. £11.933m of internal borrowing from the Council's loans fund was taken to fund the General Fund capital programme, mainly the Roads Investment Programme. The HRA borrowed £3.841m, the majority of which was to fund the Housing Investment Programme. The ongoing revenue implications from this will be met from future revenue budgets.

9. Other Implications

9.1. South Lanarkshire Council recognises that any Treasury Management Activity will carry an element of risk. It is important that risk is identified and controls put in place to limit those risks.

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

9.3. The CIPFA Treasury Management Code of Practice adopted by the Council, places Credit and Counterparty risk at the forefront of treasury risks.

9.4. South Lanarkshire Council recognises that any investment activity will carry an element of risk. It is important that risk is identified and controls put in place to limit and manage those risks.

9.5. Appendix 4 to this report details the investments that the Council was permitted to use in 2017/2018, the associated risks and the controls and limits that were put in place to mitigate these risks.

9.6. There is no requirement to carry out an environmental impact assessment in terms of the information contained within this report.

10. Equality Impact Assessment and Consultation Arrangements

10.1. This report does not introduce a new policy, function or strategy or recommend a change to an existing policy, function or strategy and, therefore, no impact assessment is required.

10.2. There is no requirement to undertake any consultation in relation to the content of the report.

Paul Manning
Executive Director (Finance and Corporate Resources)

21 May 2018

Link(s) to Council Values/Ambitions/Objectives

- Value: Accountable, effective, efficient and transparent

Previous References

- South Lanarkshire Council (Special) – 16 February 2017
- Executive Committee – 27 June 2018

List of Background Papers

- None

Contact for Further Information

If you would like to inspect the background papers or want further information, please contact:-

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Appendix 1

Treasury Management Activity Report 2017/18

1. Background

1.1. The Annual Treasury Management Activity Report is a requirement of the Council's reporting procedures and covers 2017/18. The report also includes the Treasury Management Indicators for 2017/18 in accordance with the requirements of the CIPFA Code of Practice for Treasury Management in the Public Sector and actual Prudential Indicators for 2017/18 in accordance with the requirements of the Prudential Code.

2. Introduction

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

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

- The Act permits the Scottish Ministers to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions were made in 2009/10);
- Statutory Instrument (SSI) 29 2004, requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities and, therefore, to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services;
- This Council has adopted the CIPFA Code of Practice for Treasury Management in the Public Sector and operates its treasury management service in compliance with this Code and the above requirements. These require that the prime objective of treasury management activity is the effective management of risk, and that its borrowing activities are undertaken in a prudent, affordable and sustainable basis.

2.3. The CIPFA Code of Practice requires reports to be made on its treasury management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close.

2.4. This report will cover:-

- A summary of the strategy agreed for 2017/18;
- The Council's treasury position at 31 March 2018;
- Economic Background for 2017/18;
- Actual Performance During 2017/18;
- Risk Management;
- Treasury Management and Prudential Indicators (see Appendix 2)

3. The Strategy Agreed for 2017/18

3.1. At the time of determining the strategy for 2017/18, it was felt unlikely that there would be any changes in the base interest rate unless there was a significant dip downwards in economic growth or if strong domestically generated inflation was to emerge. The first increase to 0.50% was not expected until 2019.

3.2. Public Works Loans Board (PWLB) rates and gilt yields were expected to remain volatile, with the overall long term trend being for them to gently increase.

3.3. The differential between investment earnings and debt costs was expected to remain high throughout 2017/18. This "cost of carrying" would have to be considered if borrowing was taken before our cash flow required funds as returns on deposits were expected to remain lower than the rate paid on borrowing.

3.4. The uncertainty over future interest rates resulted in the Council adopting a cautious borrowing strategy. The Executive Director of Finance and Corporate Resources, under delegated powers, would take the most appropriate form of borrowing depending on the prevailing interest rates at the time.

3.5. The main consideration when investing surplus funds was to be the security of the transaction. Liquidity would then be considered and investments would only be made for prudent time periods. Only after considering security and liquidity would the yield to be gained from the investment be considered.

3.6. The Executive Director of Finance and Corporate Resources would apply appropriate restrictions to the Council's counterparty list to ensure the security of deposits.

4. Treasury Position at 31 March 2018

4.1. The Council began the year with debt of £928.489m with fixed rate loans from the Public Works Loans Board (PWLB) making up 98.94% of the debt. By 31 March 2018, debt had decreased to £904.164m of which 98.92% was fixed rate loans from the PWLB.

4.2. Table 1 below shows the movement in borrowing to 31 March 2018.

Table 1 – Movement in Borrowing from 1 April 2017 to 31 March 2018.

	Balance as at 01/04/2017 £m	New Borrowing £m	Debt Maturing £m	Debt Repaid £m	Balance as at 31/03/2018 £m	Increase / Decrease in Borrowing £m
Short Term Borrowing	24.325	0.000	(24.325)	0.000	0.000	(24.325)
Long Term Borrowing	904.164	0.000	0.000	0.000	904.164	0.000
TOTAL BORROWING	**928.489**	**0.000**	**(24.325)**	**0.000**	**904.164**	**(24.325)**

4.3. The Treasury Position as at 31 March 2018 compared with the previous year is shown in Table 2 overleaf:

Table 2 – Treasury Position as at 31 March 2018

	31 March 2018		31 March 2017	
	Principal	**Average Rate**	**Principal**	**Average Rate**
Fixed PWLB	£894.414m	4.33%	£918.667	4.30%
Fixed Market	£0.250m	0.00%	£0.322	0.00%
Total Fixed Rate Debt	**£894.664m**	**4.32%**	**£918.989**	**4.30%**
Market	£9.500m	6.13%	£9.500m	6.13%
Total Variable Rate Debt	**£9.500m**	**6.13%**	**£9.500m**	**6.13%**
Total Debt	**£904.164m**	**4.35%**	**£928.489m**	**4.32%**
Total Deposits	**£44.980m**	**0.62%**	**£14.928m**	**0.42%**

4.4. The gross debt position fell by £24.325m from end March 2017, accounted for by decreases in PWLB (£24.253m) and repayments of the interest free loan from Salix (£0.072m).

4.5. The Council's pooled cost of borrowing is measured on an equated debt basis which takes account of how the Council's capital expenditure was funded throughout the year. The pooled interest cost together with the expenses rate for 2017/18 and the previous two years is shown in Table 3 below:

Table 3 – Pooled Cost of Borrowing

Year	Loans Fund Pooled Rate	Loans Fund Expenses Rate
2017/18	3.78%	0.06%
2016/17	3.88%	0.04%
2015/16	4.28%	0.04%

5. Economic Background for 2017/2018

5.1. The UK economy grew weakly during the first half of 2017, mainly due to an increase in inflation caused by the devaluation in Sterling after the EU referendum and a resultant increase in the cost of imported goods.

5.2. 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.

5.3. However, growth did pick up modestly in the second half of 2017. Consequently, market expectations, that the Monetary Policy Committee (MPC) would increase the base rate, rose significantly during the autumn. The minutes of the MPC meeting of 14 September indicated that the MPC was likely to raise Bank Rate very soon and on 2 November the MPC raised the base rate from 0.25% to 0.50%.

5.4. Details of significant interest rates during 2017/2018 are shown in Table 4 below.

Table 4 – Significant Interest Rates

		Borrowing Rates						
	Bank Base Rate	**1 Year PWLB**	**5 Year PWLB**	**10 Year PWLB**	**20 Year PWLB**	**30 Year PWLB**	**40 Year PWLB**	**50 Year PWLB**
High	0.50%	1.51%	2.01%	2.53%	2.90%	2.88%	2.71%	2.64%
Average	0.35%	1.11%	1.50%	2.08%	2.64%	2.65%	2.47%	2.41%
Low	0.25%	0.80%	1.14%	1.78%	2.46%	2.48%	2.30%	2.25%

6. Actual Performance during 2017/18

6.1. Capital expenditure for the year was £92.978m. During 2017/18 no long term borrowing was taken.

6.2. Deposits made in the period 1 April 2017 to 31 March 2018 totalled £1,072.754m. Further details on deposits are included in the annual investment report within this Committee paper.

7. Risk Management

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

7.2. **Investment Risk**
The main consideration when investing surplus funds is the security of the transaction. Through adoption on the CIPFA Code of Practice and through the Councils Annual Investment Strategy the Council mitigates risks associated with all our permitted investments.

7.3. **Interest Rate Risk**
The Council is currently part way through a significant capital programme funded in part by borrowing. Consideration has always been given to the optimum time to borrow funds to ensure cash flow is maintained and also that any risks of increasing borrowing interest rates are minimised.

8. Treasury Management and Prudential Indicators

8.1. The Treasury Management and Prudential Indicators are detailed in Appendix 2 to this report.

Appendix 2

Treasury Management and Prudential Indicators 2017/18

1. Treasury Management Indicators 2017/18

1.1. The revision to the Treasury Management Code has resulted in four prudential indicators now becoming Treasury Management Indicators which are to be reported alongside the Treasury Strategy.

1.2. The purpose of these is to contain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of an adverse movement in interest rates. The indicators are detailed below.

2. Upper Limit on fixed and variable rate exposure

2.1. Setting an upper limit on fixed and variable rate exposures identifies a limit for exposure to fixed and variable rates of interest. The purpose of this indicator is to provide a measure of stability against the adverse effects of market fluctuations

	2017/18 Actual £ m	2017/18 Limit £ m
Upper limit of fixed rate exposures	115.33%	180%
Upper limit of variable rate exposures	0.75%	30%

2.2. The actual fixed rate exposure is assessed by comparing the amount of Net Debt (which is borrowing less investments) we hold at a fixed rate to the Total Net Debt (both fixed and variable) of the Council. The same will be calculated for variable rate exposure.

2.3. An illustration of this calculation is shown below using year end figures for debt and investments

	£m			£m	
Total Debt	904.164				
Total Investments	(44.980)				
Total Net Debt	**859.184**				
Fixed Net Debt			**Variable Net Debt**		
Fixed Debt	894.664		Variable Debt	9.500	
Fixed Investments	0.000		Variable Investments	(44.980)	
Fixed Net Debt	**894.664**		**Variable Net Debt**	**(35.480)**	
Exposure	**104.13%**		**Exposure**	**-4.13%**	
(Fixed Net Debt / Total Net debt)			(Fixed Net Debt / Total Net debt)		

3. Maturity Structure of Borrowing

3.1. By setting limits on the maturity structure of fixed rate borrowing, the exposure to large concentrations of fixed rate debt needing to be replaced at the same time in the future at currently unknown rates can be limited. This effectively places a limit on exposure to longer term interest rate movement.

Maturity Structure of Fixed Rate Borrowings				
	Upper Limit	Lower Limit	Maximum for period to 31/03/18	Actuals as at 31/03/18
Under 12 months	15%	0%	2.65%	0.00%
12 months and 24 months	20%	0%	2.50%	2.50%
24 months and 5 years	50%	0%	9.99%	9.99%
5 years and 10 years	50%	0%	13.16%	13.16%
10 years and 20 years	60%	0%	33.78%	33.78%
20 years and 30 years	70%	0%	2.48%	2.48%
30 years and 40 years	80%	0%	33.14%	33.14%
40 years and 50 years	90%	0%	4.95%	4.95%
50 years and above	90%	0%	0.00%	0.00%

4. Total Principle Sums Invested for Greater Than 364 days

4.1. The investment regulations introduced by the Scottish Government allowed the Council to invest for periods in excess of 364 days. The Treasury Management Code requires local authorities to set an upper limit for each forward financial year period for investments longer than 364 days. The purpose is to contain the exposure to the possibility of loss that might arise as a result of having to seek early repayment of principal sums invested.

4.2. South Lanarkshire Council set a limit restricting investments for periods in excess of 364 days to no more than £10m and for no more than 5 years.

4.3. No investment was made during 2017/18 for a period in excess of 364 days.

5. Statutory Repayment of Loans Fund Advances

5.1. The Scottish Government introduced The Local Authority (Capital Financing and Accounting) Scotland Regulations 2016 with effect from 1 April 2016. These regulations require the statutory loans fund to be administered in accordance with the 2016 Regulations, proper accounting practice and prudent financial management.

5.2. The Council’s capital programmes are partly funded by planned borrowing which is advanced from the Council’s Loans Fund. Repayment of these advances is made each year and forms part of the Council’s revenue expenditure. Borrowing to fund the capital programmes therefore creates a liability to repay those advances from future years’ budgets. The Council is required to report on the commitment to repay loans fund advances.

5.3. The General Fund had an opening balance of £821.071m advances from the Loans Fund. During 2017/18, new advances of £11.933m were made to part fund the Capital Programme, while repayments of £20.107m were made from the Council’s revenue expenditure. This left a closing balance of £812.897m to be repaid over the next 40 years.

5.4. The HRA had an opening balance of £224.884m advances from the Loans Fund. During 2017/18 new advances of £3.841m were made to part fund the HRA Capital Programme, while repayments of £5.193m were made from the HRA. This left a closing balance of £223.532m to be repaid over the next 40 years.

5.5. The tables below show the repayment profile of the outstanding loans fund advances for both General Fund and HRA as at 31 March 2018. The tables do not include any planned borrowing that may be taken in future years to fund the ongoing capital programmes.

General Fund	Opening Balance	New Advances	Repayments	Closing Balance
2017/18	821.071	11.933	-20.107	812.987
2018/19	812.987	0.000	-18.936	793.961
2019/20 – 2022/23	793.961	0.000	-72.218	721.743
2023/24 – 2027/28	721.743	0.000	-95.744	625.999
2028/29 – 2032/33	625.999	0.000	-100.711	525.288
2033/34 – 2037/38	525.288	0.000	-116.397	408.891
2038/39 – 2042/43	408.891	0.000	-132.588	276.303
2043/44 – 2047/48	276.303	0.000	-138.506	137.797
2048/49 – 2052/53	137.797	0.000	-105.397	32.400
2053/54 – 2057/58	32.400	0.000	-32.400	0.000

Housing Revenue Account	Opening Balance	New Advances	Repayments	Closing Balance
2017/18	224.884	3.841	-5.193	223.532
2018/19	223.532	0.000	-5.141	218.391
2019/20 – 2022/23	218.391	0.000	-23.055	195.336
2023/24 – 2027/28	195.336	0.000	-34.270	161.066
2028/29 – 2032/33	161.066	0.000	-41.401	119.665
2033/34 – 2037/38	119.665	0.000	-44.991	74.674
2038/39 – 2042/43	74.674	0.000	-19.795	54.879
2043/44 – 2047/48	54.879	0.000	-23.841	31.038
2048/49 – 2052/53	31.038	0.000	-23.520	7.518
2053/54 – 2057/58	7.518	0.000	-7.518	0.000

5.6. The Council’s strategy for managing debt includes the early repayment of some loans within the Loans Fund. These repayments result in reduced principal and interest payments in future years and are necessary to keep loan charges affordable.

6. Prudential Code Indicators 2017/18

6.1. The Prudential Code enables Councils to take responsibility for deciding an affordable level of borrowing to fund capital expenditure. This moves away from the previous regime through which central government gave Councils consent to borrow defined amounts for capital expenditure

6.2. To meet the objectives of the Code, the Council is required to report a number of indicators, use those to demonstrate the affordability and sustainability of our capital plans and to show that good treasury management practice is adhered to.

7. Capital Expenditure and Borrowing Requirement indicators

7.1. Capital Expenditure

7.1.1 This indicator shows the capital expenditure for 2017/18. The 2017/18 estimate is also shown.

	Actual £ m	Estimate £ m	Variance £ m
General Fund Capital Expenditure	**55.640**	**78.291**	**-22.651**
Funded by:			
Borrowing	11.933	33.432	-21.499
Capital receipts and grants	42.036	43.576	-1.540
Revenue contributions	1.671	1.283	0.388
Total Funding	**55.640**	**79.291**	**-22.651**
HRA Capital Expenditure	**37.338**	**40.581**	**-3.243**
Funded by:			
Borrowing	3.841	9.890	-6.049
Capital receipts and grants	13.565	11.171	2.394
Revenue contributions	19.932	19.520	0.412
Total Funding	**37.338**	**40.581**	**-3.243**

7.1.2. The General Fund Capital Expenditure for 2017/18 was £55.640m, which is £22.651m less than estimated in the Prudential Indicators, Treasury Management Strategy and Annual Investment Strategy report presented to the Executive Committee in February 2018. The details of this have been reported to the Executive Committee over recent months, with a final position being reported on 27 June 2018.

7.1.3. The Housing Revenue Account Capital Expenditure in 2017/18 was £37.338m which is £3.243m less than the estimate reported to the Executive Committee in February 2018. The details of this have been reported to the Executive Committee over recent months, with a final position being reported on 27 June 2018.

7.2. Councils Borrowing Requirement (the Capital Financing Requirement)

7.2.1. The Council's Capital Financing Requirement (CFR) is the total outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's requirement to borrow for past and present capital expenditure and is comparable to the actual borrowing taken and finance lease liability.

7.2.2. The Council is required to pay off an element of the accumulated balance of borrowing every year through a charge to the revenue account.

7.2.3. Over the medium term, borrowing should only be for a capital purpose. Gross borrowing should not, except in the short term, exceed the CFR for 2017/18 plus any additional capital financing requirement over 2018/19 and the following two financial years. The table overleaf highlights that the Council has complied with this requirement.

7.2.4. The Capital Financing Requirement for the General Fund is £21.671m lower than forecast and for HRA is £6.078m lower than forecast. In both cases, the reason is mainly due to a reduction in borrowing required to fund the capital programme.

7.2.5. Borrowing is £162.169m less than estimated due to the fact that no borrowing was taken during 2017/18. The Council used existing cash balances in lieu of borrowing as there was no evidence of interest rates increasing and to borrow before cash was required would incur a cost of carry as the interest rates achievable on deposits continue to be less than the interest rates on borrowing.

	31 March 2018 Actual £ m	31 March 2018 Estimate £ m	Variance
General Fund Capital Financing Requirement	1,031.175	1,052.846	-21.671
HRA Capital Financing Requirement	223.544	229.622	-6.078
Total Capital Financing Requirement	**1,254.719**	**1,282.468**	**-27.749**
Treasury Position as at 31 March 2018			
Borrowing	904.164	1,066.333	-162.169
PPP Finance Lease Liability	216.138	216.135	0.003
Gross Debt	**1,120.302**	**1,282.468**	**-162.166**

7.3. Limits to Borrowing Activity

7.3.1. The Operational Boundary for external debt is based on the expected maximum external debt that could be faced in the course of the year. It is set to accommodate the borrowing requirements, and also includes sufficient scope to allow for changes to the capital programme throughout the year. This limit may be breached during the year, and this will be reported in the Prudential report presented to Committee after year end.

7.3.2. The Authorised Limit for External Debt represents a limit beyond which external debt is prohibited. It represents the level of external debt which could be afforded in the very short-term, but is not sustainable in the longer term without consideration to revenue budgets. This limit would not be breached without the Finance and Corporate Resources Committee being advised.

7.3.3 It must be noted that the future for public sector funding remains uncertain and that this is a position which will require continual review.

	2017/18 £ m
Operational Limit for External Debt	1,150.000
Authorised Limit for External Debt	1,170.000
Maximum Borrowing Position During the Period	**928.489**
Operational Limit for Other Liabilities (PPP/Finance Lease)	230.000
Authorised Limit for Other Liabilities (PPP/Finance Lease)	230.000
Maximum PPP/Finance Lease Liability	**222.894**

7.3.4. The table demonstrates that during 2017/18 the Council maintained its borrowing and other liabilities within their Authorised Limits and Operational Boundaries.

8. Affordability Indicators

8.1. Ratio of Financing Costs to Net Revenue Stream

8.1.1. This indicator focuses on the extent to which the Council's net revenue budget is used for servicing debt. This is shown for both General Fund and HRA.

	2017/18 Actual £ m	2017/18 Estimate £ m
General Fund Ratio of Financing Costs to Net Revenue Stream (expressed as %)	8.85%	9.06%
HRA General Fund Ratio of Financing Costs to Net Revenue Stream (expressed as %)	16.95%	17.23%

8.1.2. The General Fund Ratio is less than forecast as financing costs were lower than anticipated due to the fact that no borrowing was taken in 2017/18. The Net Revenue Stream for General Fund was also higher than forecast which caused a further reduction in the ratio.

8.1.3. The HRA ratio is less than forecast as financing costs were lower than anticipated due to the fact that no borrowing was taken in 2017/18. This was offset slightly by a lower than forecast Net Revenue Stream.

8.2. Estimates of the Incremental impact of capital investment on Council Tax and Council House Rents

8.2.1. A revision of the Prudential Code was issued by CIPFA in December 2017. The key objectives of the Code remain unchanged and are to ensure, within a clear framework, that Local Authorities capital investment plans are affordable, prudent and sustainable and that treasury management decisions are taken in accordance with good professional practice and in full understanding of the risks involved and how these risks will be managed to levels that are acceptable to the organisation.

8.2.2. The major change to the updated code is the removal of the indicator showing the incremental impact of capital investment on Council Tax and House Rents. As these indicators are no longer required by the Prudential Code they will no longer be reported.

9. Treasury Management Indicators

9.1. Adherence to the CIPFA Treasury Code of Practice

9.1.1. South Lanarkshire Council adopts the CIPFA TM code through which assurance is given that the Council has formal treasury objectives, policies and practices; that priority is given to identifying and controlling risk, and that proper reporting arrangements are established.

Appendix 3

Annual Investment Report

1. Permitted Investments

1.1. During 2017/18 South Lanarkshire Council only used the following permitted investments

- Deposits with the Debt Management Account Deposit Facility
- Deposits with UK Local Authorities
- Deposits with Banks and Building Societies
- UK Government Treasury Bills

1.2. Deposits made in the period 1 April 2017 to 31 March 2018 totalled £1,072.754m. This is broken down per sector and institution in the table below. 70.02% of these deposits were made in the UK Government through the Debt Management Office (DMO) deposit facility or in Treasury Bills.

Counterparty	Deposit Totals (£m)	% of Total Deposits	Average Interest Rate
Deposits in UK Government			
Debt Management Account Deposit Facility	708.600	66.06%	0.14%
Treasury Bills	42.492	3.96%	0.23%
Total Deposits in UK Government	**751.092**	**70.02%**	**0.14%**
Deposits in UK Local Authorities	**279.260**	**26.03%**	**0.30%**
Deposits in UK Banks and Building Soc.			
Bank of Scotland	42.402	3.95%	0.26%
Total Deposits in UK Banks	**42.402**	**3.95%**	**0.26%**
Total Deposits 01/04/2017 to 31/03/2018	**1,072.754**	**100.00%**	**0.19%**

1.3. The average interest rates achieved from the deposits are shown in the table above. The base bank interest rate increased to 0.50% from 0.25% on 2 November 2017.

1.4. Actual deposits as at 31 March 2018 totalled £44.980m.

2. Risk Management

2.1. The following minimum thresholds were set in the strategy for all deposits with banks and building societies, including Certificate of Deposits.

Rating Agency	Long Term Rating	Maximum Deposit
Fitch	A-	£10m
Moody’s	A3	£10m
Standard and Poors	A-	£10m

2.2. Prior to depositing funds with any bank or building society, additional indicators of creditworthiness (such as short term and secondary credit ratings, credit default swaps, Gross Domestic Product (GDP); net debt as a percentage of GDP, potential sovereign and parental support, share price) will also be considered.

2.3. The tables below show a breakdown of deposits with details of the credit ratings of banks and building societies used from 1 April 2017 to 31 March 2018. Deposits with the DMO are with the UK Government and so have a very high credit rating. Deposits with local authorities are considered to be of very high credit quality despite most local authorities not having formal credit ratings.

Fitch Ratings

Long Term Rating	Short Term Rating	Deposits Totals	Percentage of Total Deposits
Deposits in DMO (AA)		708.600m	66.06%
Deposits in T-Bills		42.492m	3.96%
Deposits with Local Authorities		279.260m	26.03%
A+	F1	42.402m	3.95%
Total		**1,072.754m**	**100.00%**

Moody's Ratings

Long Term Rating	Short Term Rating	Deposits Totals	Percentage of Total Deposits
Deposits in DMO (Aa1/Aa2)		708.600m	66.06%
Deposits in T-Bills		42.492m	3.96%
Deposits with Local Authorities		279.260m	26.03%
Aa3	P-1	23.200m	2.16%
A1	P-1	19.202m	1.79%
Total		**1,072.754m**	**100.00%**

Standard and Poor's Ratings

Long Term Rating	Short Term Rating	Deposits Totals	Percentage of Total Deposits
Deposits in DMO (AA)		708.600m	66.06%
Deposits in T-Bills		42.492m	3.96%
Deposits with Local Authorities		279.260m	26.03%
A	A-1	42.402m	3.95%
Total		**1,072.754m**	**100.00%**

2.4. The tables show that 96.05% of deposits were made with counterparties of very high credit quality (UK Government DMO account, Treasury Bills and other local authorities). All deposits made by the Council were in line with approved lending limits and credit rating criteria.

2.5. In order to manage liquidity risk, the Council held an average of £9.721m in bank accounts with instant access.

2.6. No deposits were placed for periods in excess of 364 days.

3. Borrowing in Advance

3.1. No borrowing was taken during 2017/18.

Appendix 4

Permitted Investment	**Treasury Risks**	**Mitigating Controls**	**Limits**
Deposits with the Debt Management Account Deposit Facility	This is a deposit with the UK Government and so credit risk is very low. Liquidity risk has to be considered as deposits can only be broken with the agreement of the counterparty and penalties may apply. There is no market risk as the principal sum invested is not affected by market prices.	There are no mitigating controls required.	There is no maximum monetary limit. A maximum term of deposit of six months as set by the Debt Management Office.
Deposits with UK Local Authorities and other bodies defined as local authorities in the Local Government Scotland Act 2003 (And Equivalent English Act)	These are considered to be quasi UK Government investment and as such credit risk is very low. Liquidity risk has to be considered as deposits can only be broken with the agreement of the counterparty and penalties may apply. There is no market risk as the principal sum invested is not affected by market prices.	There are no mitigating controls required.	The maximum deposit with any local authority will be £15m for deposits less than one year. Deposits in excess of one year will be subject to a maximum term of deposit of three years and be limited to £10m.
Deposits with Banks and Building Societies	These tend to be low risk but credit risk will be higher than deposits placed with the DMO or UK local authorities. Liquidity risk has to be considered as deposits can only be broken with the agreement of the counterparty and penalties may apply. There is no market risk as the principal sum invested is not affected by market prices.	The counterparty selection criteria restricts lending only to high quality counterparties, measured initially by credit ratings from Fitch, Moody's and Standard and Poors. Additional indicators of creditworthiness will also be considered prior to placing any deposits. Liquidity risk can be controlled by the use of instant access call accounts.	The maximum deposit with any bank or building society will be £10m. A maximum term of deposit of 364 days.

Certificates of Deposit with Banks and Building Societies	These are short to medium term dated marketable securities issued by financial institutions. These tend to be low risk investments but credit risk will be higher than deposits placed with the DMO or UK local authorities. Liquidity risk is lower than placing a deposit with a Bank or Building Society as these can be sold on the market. There is a risk of capital loss arising from selling ahead of maturity.	The counterparty selection criteria restricts lending only to high quality counterparties, measured initially by credit ratings from Fitch, Moody's and Standard and Poor's. Additional indicators of creditworthiness will also be considered prior to using this type of instrument. Market risk would be mitigated by holding the instrument to maturity.	The maximum investment with any bank or building society will be £10m. A maximum period of investment of 364 days.
UK Government Gilts and Treasury Bills	These are marketable securities issued by the UK Government and as such credit risk is very low. Liquidity risk is very low as there is a huge market for Gilts and Treasury Bills There is a risk of capital loss arising from selling ahead of maturity.	There are no mitigating controls required for credit risk as the investment is with the UK Government. Market risk would be mitigated by holding the instrument to maturity.	There is no maximum limit to investments in UK Gilts or Treasury Bills for maturities less than one year and a limit of £10m for maturities greater than one year. The maximum period of investment will be five years.
AAA Rated Bonds Issued by Multilateral Development Banks	These are bonds issued by supranational bodies such as the European Investment Bank or World Bank and as a result are backed by several sovereign states and as such credit risk is very low. Liquidity risk is very low as there is a large market for Supranational Bonds. There is a risk of capital loss arising from selling ahead of maturity.	As the investment is effectively spread across a number of sovereign states, the Council will mitigate the credit risk of holding such bonds by considering the sovereign rating of the underlying sovereign states and only holding bonds that have a AAA rating. Market risk would be mitigated by holding the instrument to maturity.	The maximum amount that will be invested in AAA Rated Bonds issued by Multilateral Development Banks is £10m. The maximum period of investment will be five years.

AAA Rated Money Market Funds	Money market funds are pooled funds that invest in short-term money market instruments and other debt instruments. The underlying investments are diversified and Credit risk, liquidity risk and market risk are all very low. Investments in these MMFs are highly liquid (same day liquidity).	Money Market Funds will only be used where they have obtained a AAA rating from the credit rating agencies. In addition to the credit rating, Money Market Funds will also be assessed for suitability on fund size, the strength of the custodian and the stability of invested capital.	Investments in Money Market Funds will be limited to 0.5% of the Money Market Fund Balance and to no more than £10m in any one Fund. Investments in Sterling Government Money Market Funds which only invest in Sterling denominated short term debt securities issued by the UK Government will be restricted to 2% of the Money Market Fund size and to no more than £10m in any individual Money Market Fund.
Loans to Third Parties	These are service investments which may exhibit credit risk and are likely to be highly illiquid.	Any new types of loans to third parties should be approved by Members through the appropriate Committee with full consideration of the service rationale behind the loan and the likelihood of partial or full default and the impact that this will have on service budgets.	