

BODY: **AUDIT & GOVERNANCE COMMITTEE**

DATE: **29 November 2017**

SUBJECT: **Treasury Management Mid-year Review Report**

REPORT OF: **Chief Finance Officer**

Ward(s): All

Purpose: To provide Members with a mid year review of treasury management activity.

Contact: Janet Martin, Senior Accountant
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Recommendations: Members are asked to note the contents of this report.

1.0 Introduction

- 1.1 Treasury Management is the management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.
- 1.2 The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management was adopted by Cabinet on 3 February 2016 and requires regular reports to this committee on the Treasury Management activities undertaken.
- 1.3 This mid year report covers the following:
- An economic update for the first six months of 2017/18;
 - A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
 - The Council's capital expenditure (prudential indicators);
 - A review of the Council's investment portfolio for 2017/18;
 - A review of the Council's borrowing strategy for 2017/18;
 - A review of any debt rescheduling undertaken during 2017/18;
 - A review of compliance with Treasury and Prudential Limits for 2017/18.

2.0 Economic Update

- 2.1 After the UK economy surprised the market with strong growth in 2016, growth in 2017 has been disappointingly weak; quarter 1 came in at only +0.3% (+1.7% y/y) and quarter 2 was +0.3% (+1.5% y/y) which meant that growth in the first half of 2017 was the slowest for the first half of any year since 2012. The main reason for this has been the sharp

increase in inflation, caused by the devaluation of sterling after the referendum, feeding increases in the cost of imports into the economy. This has caused, in turn, a reduction in consumer disposable income and spending power and so the services sector of the economy, accounting for around 75% of GDP, has seen weak growth as consumers cut back on their expenditure. However, more recently there have been encouraging statistics from the manufacturing sector which is seeing strong growth, particularly as a result of increased demand for exports. It has helped that growth in the EU, our main trading partner, has improved significantly over the last year. However, this sector only accounts for around 11% of GDP so expansion in this sector will have a much more muted effect on the average total GDP growth figure for the UK economy as a whole.

The Monetary Policy Committee (MPC) meeting of 14 September 2017 surprised markets and forecasters by suddenly switching to a much more aggressive tone in terms of its words around warning that Bank Rate will need to rise. The Bank of England Inflation Reports during 2017 have clearly flagged up that they expected CPI inflation to peak at just under 3% in 2017, before falling back to near to its target rate of 2% in two years time. Inflation actually came in at 2.9% in August, (this data was released on 12 September), and so the Bank revised its forecast for the peak to over 3% at the 14 September meeting MPC.

On 2nd November the MPC increased Bank Rate to 0.5%. The big question after that will be whether this is a one off increase or the start of a slow, but regular, increase in Bank Rate. As at the start of October, short sterling rates are indicating that financial markets do not expect a second increase until May 2018 with a third increase in November 2019. However, some forecasters are flagging up that they expect growth to improve significantly in 2017 and into 2018, as the fall in inflation will bring to an end the negative impact on consumer spending power while a strong export performance will compensate for weak services sector growth. If this scenario were to materialise, then the MPC would have added reason to embark on a series of slow but gradual increases in Bank Rate during 2018. While there is so much uncertainty around the Brexit negotiations, consumer confidence, and business confidence to spend on investing, it is far too early to be confident about how the next two years will pan out.

2.2 Interest Rate Forecast

The Council's treasury advisor, Link Asset Services (formerly Capita Asset Services), has provided the following forecast:

	NOW	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20
BANK RATE	0.50	0.50	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.25
3 month LIBID	0.40	0.40	0.40	0.40	0.40	0.60	0.60	0.60	0.70	0.90	0.90	1.00	1.20
6 month LIBID	0.45	0.50	0.50	0.50	0.60	0.80	0.80	0.80	0.90	1.00	1.00	1.10	1.30
12 month LIBID	0.65	0.70	0.80	0.80	0.90	1.00	1.00	1.10	1.10	1.30	1.30	1.40	1.50
5 yr PWLB	1.50	1.50	1.60	1.60	1.70	1.80	1.80	1.90	1.90	2.00	2.10	2.10	2.20
10 yr PWLB	2.10	2.10	2.20	2.30	2.40	2.40	2.50	2.60	2.60	2.70	2.70	2.80	2.90
25 yr PWLB	2.70	2.80	2.90	3.00	3.00	3.10	3.10	3.20	3.20	3.30	3.40	3.50	3.50
50 yr PWLB	2.40	2.50	2.60	2.70	2.80	2.90	2.90	3.00	3.00	3.10	3.20	3.30	3.30

Link Asset Services (Link) undertook its last review of interest rate forecasts on 7 November after Bank rate was increased to 0.5%. Economic forecasting remains difficult with so many external influences weighing on the UK. Link's forecasts will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year.

3.0 Treasury Management Strategy Statement and Annual Investment Strategy Update

3.1 The Treasury Management Strategy Statement (TMSS) for 2017/18 was approved by Cabinet on 8 February 2017. The Council's Annual Investment Strategy, which is incorporated in the TMSS, outlines the Council's investment priorities as follows:

- Security of capital
- Liquidity.

There are no policy changes to the TMSS.

3.2 The Council aims to achieve the optimum return (yield) on investments commensurate with the proper levels of security and liquidity and to obtain an appropriate level of return which is consistent with the Council's risk appetite.

3.3 There is still uncertainty and volatility in the financial and banking market globally. In this context, it is considered that the strategy approved on 8 February 2017 is still fit for purpose in the current economic climate.

4.0 The Council's Capital Position (Prudential Indicators)

4.1 Prudential Indicator for Capital Expenditure

The table below shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the Budget.

Capital Expenditure	2017/18 Original Estimate £m	Position as at 30.9.17 £m	2017/18 Revised Estimate £m
General Fund	39.8	31.0	70.3
HRA	4.3	2.0	8.8
Total	44.1	33.0	79.1

4.2 Changes to the Financing of the Capital Programme

The table below draws together the main strategy elements of the capital expenditure plans (above), and the expected financing arrangements of this capital expenditure. The borrowing element of the table increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

Capital Expenditure	2017/18 Original Estimate £m	2017/18 Revised Estimate £m
Total spend	44.1	79.1
Financed by:		
Capital receipts	11.5	4.0
Capital grants	6.2	10.2
Capital reserves	4.2	6.4
Revenue	-	0.6
Total financing	21.9	21.2
Borrowing need	22.2	57.9

The increase in the revised estimated capital spend in 2017/18 is mainly due to:

- Re-profiling of previously approved schemes, mainly Hampden Retail Park which was expected to complete in March 2017 but actually completed in May 2017 (£18.2m) and other reprofiling including those relating to JTP, Devonshire Park, EHIC loans and Land & Acquisitions;
- New schemes approved relating to EHIC and Aspiration Homes totalling £30m, of which £3m has been profiled in 2017-18;
- Changes to HRA capital programme totalling £4.5m relate to the HEDP schemes and a new scheme of £262k for the conversion of the Riverbourne kitchen.

4.3 Changes to the Prudential Indicators for the Capital Financing Requirement, External Debt and the Operational Boundary.

The table below shows the CFR, which is the underlying external need to incur borrowing for a capital purpose. It also shows the expected debt position over the period. This is termed the Operational Boundary.

	2017/18 Original Estimate £m	2017/18 Revised Estimate £m
Prudential Indicator – Capital Financing Requirement		
CFR – non housing	73.4	102.6
CFR – housing	42.6	42.8
Total CFR	116.0	145.4
Net movement in CFR	20.5	56.5
Prudential Indicator – External Debt / the Operational Boundary		
Borrowing	96.0	
Serco Paisa Loans	⁴ 0.5	
Total debt 31 March	96.5	

The revised estimate has been increased from the original forecast Capital Financing Requirement due to the increased borrowing for EHIC Loan, Aspiration Homes and changes to the financing of the Devonshire Park Project.

There is a requirement to increase the Operational Boundary and this will formally submitted to Cabinet in December 2017.

4.4 **Limits to Borrowing Activity**

One key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Net external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2017/18 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

	2017/18 Original Estimate £m	Position As at 30.9.17 £m	2017/18 Revised Estimate £m
Gross borrowing	96.0	91.0	122.0
Serco Paisa Loans	0.5	0.7	0.5
Less investments	-	(2.0)	-
Net borrowing	96.5	89.7	122.5
CFR (year end position)	116.0	116.0	145.4

It is important to note that the CFR revised estimate includes uncommitted borrowing of £6.8m in 2017-18 which relates to facilities agreed by Cabinet but there has been no commitment to borrow funds which will be dependent on the viability and profitability of proposed schemes.

No difficulties are envisaged for the current or future years in complying with this prudential indicator.

A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Authorised limit for external debt (£m)	2017/18 Original Indicator	2017/18 Revised Indicator*	Current Position

Borrowing	96.0	146.4	91.0
Other long term liabilities	0.5	0.5	0.7
Total	96.5	146.9	91.7

* Agreed Cabinet 12th July 2017

5.0 Investment Portfolio 2017/18

5.1 Investment rates available in the market continue at a historical low point. The average level of temporary funds available for investment purposes in the first six months of 2017/18 was £4.5m arising from the timing of precept payments, receipt of grants and progress on the capital programme.

5.2 A full list of investments held as at 30 September 2017 is shown in the table below. All investments are with British Banks and Building Societies:

Counterparty	Term	£m	Rate of Return %
Santander	On Call	2.0	0.55
Total		2.0	

The above figures exclude the balance held on the Council's current accounts with Lloyds Bank of £565,000 at a rate of 0.15%

Approved limits within the Annual Investment Strategy were not breached during the first six months of 2017/18.

5.3 Investment performance against benchmark was as follows:

Benchmark	Benchmark Return	Council Performance	Interest Earnings
7 day	0.11%	0.38%	£8,500

5.4 The authority outperformed the benchmark by 0.27%. The budgeted investment return for 2017/18 is £50,000. Performance for the year to date is below target due to cash balances being utilised instead of borrowing. The continuous use of internal balances is in line with the Council's strategy and reduces the amount of interest paid on loans.

5.5 Investment Counterparty criteria

The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function.

6.0 Borrowing

6.1 The following new loans were drawn down:

Lender	Amount £m	Interest Rate %	Start Date	Repayment Date
PWLB	2.0	2.43	15/5/2017	24/9/2058

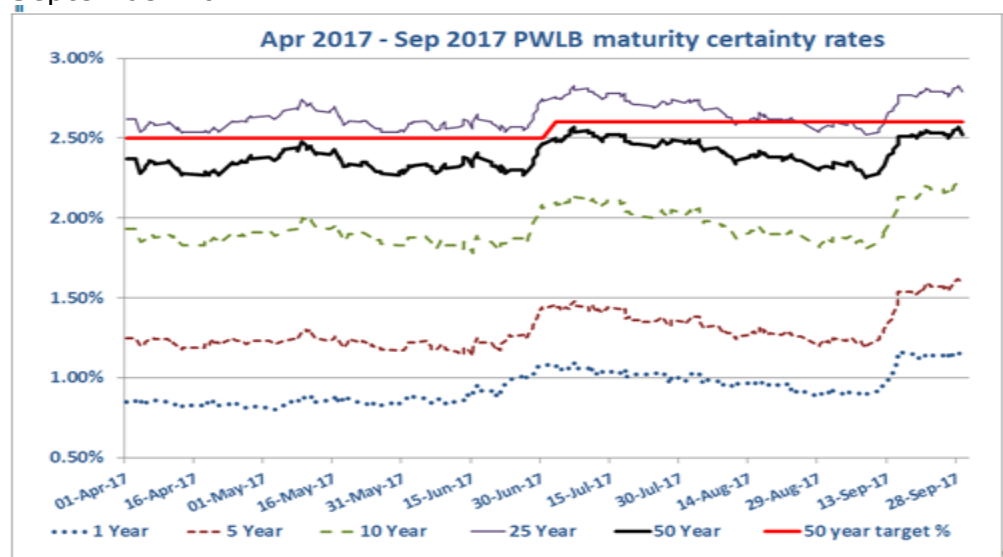
PWLB	2.0	2.41	15/5/2017	24/3/2062
PWLB	2.0	2.40	15/5/2017	24/3/2065
PWLB	2.0	2.33	22/5/2017	24/9/2066
PWLB	2.0	2.33	22/5/2017	24/3/2067
PWLB	2.0	2.39	11/8/2017	24/9/2066
PWLB	2.0	2.33	15/8/2017	24/9/2065
PWLB	2.0	2.30	31/8/2017	24/9/2062
Total	16.0			

One loan with PWLB for £3m was repaid during the first 6 months of the year.

As at 30.9.17 the Council had temporary borrowing of £18m at an average rate of 0.29%. This is short term borrowing from four Local Authorities which is being renewed periodically in accordance with cash flow needs.

6.2 The Council's revised estimated capital financing requirement (CFR) for 2017/18 is £145.4m. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions. The table above at 4.4 shows the Council has net borrowings of £91.7m and has utilised £24.3m of cash flow funds in lieu of borrowing. This is a prudent and cost effective approach in the current economic climate.

6.3 The graph below shows the movement in PWLB rates for April to September 2017.



7.0 Debt Rescheduling

7.1 Debt rescheduling opportunities have been limited in the current

economic climate and consequent structure of interest rates. No debt rescheduling was undertaken during the first six months of 2017/18.

8.0 Compliance with Treasury and Prudential Limits

8.1 It is a statutory duty for the Council to determine and keep under review the "Affordable Borrowing Limits". Council's approved Treasury and Prudential Indicators (affordability limits) are outlined in the approved TMSS.

8.2 During the financial year to date the Council has operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices.

9.0 Consultation

9.1 None.

10.0 Resource Implications

10.1 None

Janet Martin
Senior Accountant

Background Papers:

The Background Papers used in compiling this report were as follows:

- CIPFA Treasury Management in the Public Services code of Practice (the Code)
- TMSS Policy
- Annual Investment Strategy

To inspect or obtain copies of background papers please refer to the contact officer listed above.