TREASURY MANAGEMENT MID-YEAR REPORT 2018/19

Cabinet Member: Councillor D Watson

Wards affected: All

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PROPOSED DECISION

Subject to any observations from the Audit Committee, that the treasury management mid-year report for 2018/19, covering the period 1 April 2018 to 30 September 2018 be considered and noted.

Reason for Decision

To promote effective financial management and comply with the Local Authorities (Capital Finance and Accounting) Regulations 2003 and other relevant guidance.

The Committee is responsible for ensuring effective scrutiny of the Treasury Management Strategy.

Corporate Implications

1. The financial implications are contained within this report.
2. The main financial risks to the Council have been reviewed as part of this report.

Executive Summary

3. The purpose of this report is specifically to meet the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2011).
4. This is a mid-year report of Treasury Management activities. The report details progress during the year against the Strategy approved by Council on 22 February 2018.
5. It is recommended that the committee considers and notes the report. This report will be considered by the Cabinet on 12th November 2018.

Council Priorities

6. Treasury management activity plays a significant part in supporting the delivery of all the Council's corporate priorities.

Background

7. The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

8. The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

9. Accordingly, treasury management is defined as:

   "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."

10. The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2011) has been adopted by this Council.

11. The primary requirements of the Code are as follows:

    a. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

    b. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.

    c. Receipt by the full council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review Report and an Annual Report (stewardship report) covering activities during the previous year.

    d. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

    e. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is The Audit Committee.

12. The purpose of this report is specifically to meet the mid-year reporting requirements and covers the following for the financial year 2018/19:

    - A review of the Treasury Management Strategy Statement (TMSS) (paragraph 13);
    - The Council's Capital Expenditure and Prudential Indicator (paragraphs 14 to 18);
    - A review of the Council's Investment Portfolio & Review of Investment Strategy (Paragraphs 19 to 23);
    - A review of the Council's Borrowing Strategy and debt rescheduling (Paragraphs 24 to 26);
    - Other updates (Paragraphs 27 to 29)
    - An economic update (Appendix A);

Treasury Management Strategy Statement

13. The TMSS was approved by the Council on 22nd February 2018. There are no policy changes to the TMSS; the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

The Council's Capital Position

14. This part of the report provides an update on:

- The Council's capital expenditure and funding plans;
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity.

Capital expenditure and funding

15. The table below shows the revised estimates for capital expenditure and the expected financing arrangement for the capital expenditure.

Table 1

2018/19	Approved Programme (February 2018 Council) £000	Revised Programme £000	Forecast Outturn £000
Capital expenditure			
Community	2,111	683	830
Economic Development & Regeneration	17,856	13,392	13,596
Housing	5,038	2,232	2,232
CIL, S106 & other External funding	18,589	6,851	6,815
Planning & Sustainability	153	153	127
HR, ICT & Customer Services	1,148	795	795
Leader	463	463	460
Capitalisation of Staff cost		308	308
Total	**45,358**	**24,877**	**25,163**
Financed by:			
Capital receipts	20,720	16,810	15,996
Capital grants	8,595	1,480	1,480
CIL & Section106	10,900	6,587	7,687
Revenue	5,143	-	-
Total	**45,358**	**24,877**	**25,163**

Prudential Indicators

16. The table below shows :-

- **Capital Financing Requirement (CFR)** – The CFR measures the extent to which capital expenditure has not yet been financed from either revenue or capital resources. It is essentially a measure of the Council's indebtedness and so it's underlying borrowing need. Any capital expenditure, which has not immediately been financed or paid for, will increase the CFR.
- **Authorised Limit for External Debt** – This is the limit prescribed by section 3(1) of the Local Government Act 2003 representing the maximum level of

borrowing which the Council may incur. It reflects the level of external debt which, while not desired, could be afforded in the short term, but may not be sustainable in the longer term.

- **Operational Boundary** – This is the limit which external debt is not normally expected to exceed. The boundary is based on current debt plus anticipated net financing need for future years.

Capital Financing Requirements	**2018/19**	**2018/19**	**2018/19**
	Approved	**Revised**	**Forecast**
	£m	**£m**	**£m**
Gross Projected Debt	1.606	1.606	1.606
CFR 31st March	4.894	4.873	4.873
Under borrowing	**3.288**	**3.267**	**3.267**
Borrowing and Investment Limits	**2018/19**	**2018/19**	**2018/19**
	Approved	**Revised**	**Forecast**
	£m	**£m**	**£m**
Authorised Limit for external debt			
Borrowing and other long term liabilities	10	10	10
Operational Boundary for external debt			
Borrowing	3	3	3
Other long term liabilities	2	2	2
Total	5	5	5
Upper limit for fixed interest rate exposure			
Net principal re fixed rate borrowing	3	2	0
Upper limit for variable rate exposure			
Net principal re variable rate borrowing	0	0	0
Upper limit for principal sums invested over 364 days	40	40	40

Compliance with limits for borrowing activity

17. The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total CFR in the preceding year plus the estimates of any additional CFR for 2018/19 and next two financial years.

18. The Head of Finance and Commercial reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator. This view takes into account current commitments, existing programme and the proposals in the budget report.

Investment Portfolio

19. As at 30 September 2018, the Council did not have any external borrowing and the treasury investments were £86.8m earning an average rate of return at 1.03%. The Treasury position as at 30 September 2018 is summarised in the table below:-

	As at September 18		As at March 18	
	£m	%	£m	%
Specified Investments (up to 1 year)				
Banks & Building Socities	50.5	58%	39.55	49%
Local Authorities	5.0	6%	0.0	0%
Money Market Funds	10.8	12%	15.0	19%
Non-Specified Investments (longer than 1 year)				
Local Authorities	13.0	15%	13	16%
Property Fund	7.5	9%	7.5	9%
Gilt	0.0	0%	4.98	7%
Total Investments	**86.8**	**100%**	**80.03**	**100%**

20. The Council's budgeted investment return for 2018/19 is £539k, and performance for the year to date is above budget generating a favourable variance of £200k due to better returns than budgeted and the cash balance higher than expected due to delays in spend on the Capital Programme. The average investment return during the first six months is 1.03% compared to the 3 month LIBOR rate of 0.73% as summarised in the table below:-

Returns	Sep-18	Mar-18
Benchmark 7 day LIBID	0.43%	0.21%
Benchmark 3 month LIBOR	0.73%	0.41%
Actual	1.03%	0.73%

London Interbank Bid Rate (LIBID) – The rate at which a bank is willing to borrow from other banks.
London Interbank Offered Rate (LIBOR) – It is the average of interest rates estimated by each of the leading banks in London that it would be charged were it to borrow from other banks.

21. Council has invested £7.500m in the CCLA Property Fund in December 2017. The Dividend is paid quarterly in arrears net of management charges and the returns up to the 1st quarter of 2018/19 are summarised below:-

Period	Net Dividend	% Net yield on Original Investment of £7.5m	% Net yield on Net Investment (less cost) of £7.025m
2017/18 (4 months)	105,626.44	4.23%	4.51%
2018/19 1st Quarter	77,908.99	4.16%	4.44%

22. The Treasury activity has been in compliance with the investment strategy and during the first six months of the year there have been no instances of breach of counter parties.

Review of Investment Strategy

23. In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is

consistent with the Council's risk appetite. As shown by forecasts in economic update in appendix A, it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low and in line with the current 0.75% Bank Rate. Given the fact that increases in Bank Rate are likely to be gradual and unlikely to return to the levels seen in previous decades, investment returns are likely to remain low.

Review of Borrowing Strategy and Debt Rescheduling

24. The Council does not have any external borrowing and none has been taken out during the six months period to 30 September 2018.

25. With low interest rates and counter party risks, the Council's strategy continues to utilise internal borrowing to support the capital programme.

26. As the Council is debt free, there are no debt rescheduling opportunities to consider.

Other Updates

27. **UK Banks – ring fencing**
The largest UK banks, (those with more than £25bn of retail / Small and Medium-sized Enterprise (SME) deposits), are required, by UK law, to separate core retail banking services from their investment and international banking activities by 1st January 2019. This is known as "ring-fencing". Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler, activities offered from within a ring-fenced bank, (RFB), will be focused on lower risk, day-to-day core transactions, whilst more complex and "riskier" activities are required to be housed in a separate entity, a non-ring-fenced bank, (NRFB). This is intended to ensure that an entity's core activities are not adversely affected by the acts or omissions of other members of its group.While the structure of the banks included within this process may change, the fundamentals of credit assessment would not. The Council will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings, (and any other metrics considered), will be considered for investment purposes.

28. **IFRS 9 Accounting Standard – Financial Instrument**

This accounting standard came into effect from 1st April 2018. It means that the category of investments valued under the available for sale category will be removed and any potential fluctuations in market valuations may impact onto the Surplus or Deficit on the Provision of Services, rather than being held on the balance sheet. This change is unlikely to materially affect the commonly used types of treasury management investments but more specialist types of investments, (e.g. pooled funds, third party loans, commercial investments), are likely to be impacted. Currently the Council holds an investment of £7.5m in Property Pooled Fund which will be impacted by the new accounting standard.

29. The Ministry of Housing, Communities and Local Government (MHCLG), are currently conducting a consultation for a temporary override to allow English local authorities to adjust their portfolio of investments. Members will be updated on the potential impact for WDC when the result of this consultation is known.

Background papers:Treasury Management strategy approved by Council in February 2018.