

Report to: **Audit Committee**  
Date: **30 January 2018**  
Title: **Treasury Management Mid-Year Review**  
Portfolio Area: **Support Services – Cllr C Edmonds**  
Wards Affected: **ALL**  
Relevant Scrutiny Committee:

Urgent Decision: **N** Approval and clearance obtained: **Y**

Author: Alex Walker Role: **Finance Business Partner**

Contact: Email [alexandra.walker@swdevon.gov.uk](mailto:alexandra.walker@swdevon.gov.uk) 01803 861345

---

<p><b>Recommendations:</b> <b>That the contents of the report are endorsed.</b></p>
---

## **1. Executive summary**

To date, the Council has outperformed the industry benchmark by 0.27%. The Council has achieved a rate of return of 0.38%, against the 7 day LIBID bid rate (LIBID) of 0.11%. Following the rise in the Bank Base Rate on 2 November 2017, the Council is predicting that the investment income target of £70,321 will be achieved in 2017/18.

## **2. Background**

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 maximising investment return.

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.

The Council currently has a £2.1 million loan with the Public Works Loan Board. In December 2017, the Council approved an amendment to the Property Acquisition Strategy, which enables the Council to borrow up to £37.45 million (for a £35 million portfolio plus acquisition costs of 7%).

Further borrowing of £2.55 million to fund a Residential Property Purchase (Minute HC53) was also approved. This borrowing will not take place until 2019/20 at the earliest.

At Council in February 2017, it was approved (Minute CM54 and HC50) that a sum of £500,000 be used to invest in CCLA's (CCLA Investment Management Limited) Local Authorities Property Fund, with the investment being placed in April 2017.

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."

The Council's Finance Procedure Rules require that a report be taken to the Audit Committee three times a year on Treasury Management. The specific reporting requirements are:

- An annual treasury strategy in advance of the year (Audit Committee 21/03/2017 – AC32)
- A mid-year (minimum) treasury update report (This report)
- An annual review following the end of the year describing the activity compared to the strategy

The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management recommends that Members be updated on treasury management activities regularly (i.e. Treasury Management Strategy Statement (TMSS), annual and midyear reports). This report therefore ensures this Council is implementing best practice in accordance with the Code.

## **Economic Background**

### **Monetary Policy Committee (MPC) meeting 2 November 2017**

Earlier this month we saw two major developments: -

1. The MPC duly voted 7-2 to remove the post EU referendum emergency monetary stimulus implemented in August 2016 by reversing the cut in Bank Rate at that time from 0.5% to 0.25%, (with no change in QE this time). In view of the robust rate of growth in the second half of 2016 which confounded the Bank's August 2016 forecasts for a sharp slowdown, many commentators subsequently held the view that that emergency action was unnecessary.
2. The MPC also gave forward guidance that they expected to increase Bank Rate only twice more in the next three years to reach 1.0% by 2020. This is, therefore, not quite the 'one and done' scenario but is, nevertheless, a very relaxed rate of increase prediction in Bank Rate in line with previous statements that Bank Rate would only go up very gradually and to a limited extent.

The quarterly Inflation Report itself, was notably downbeat about economic growth based on a view that the trend rate of growth for the economy has now fallen from 2.2% to only 1.5%, (whereas in the decade before the financial crash it grew at 2.9% p.a.). One of the main focuses for this was a view that productivity growth would remain very weak at about only 1% p.a.

This, in turn, is likely to feed through into weak domestically generated, (i.e. excluding the one off post referendum imported inflation through the fall in the value of sterling), price pressures underpinning CPI inflation. Overall, the Inflation Report was little changed from the August report and again forecast that inflation would be barely above the 2% target at the three year time horizon; it is also expected to peak very soon at 3.2%, (September was 3.0%), before falling thereafter as the devaluation effect gradually falls out of the 12 month statistics. As for forecasts for GDP growth, these also barely changed with growth falling from 1.7% to 1.6% for 2017 and being unchanged for 2018 (1.6%) and 2019 (1.8%). The MPC was also quite concerned about the situation over Brexit as there has been little significant agreement so far in terms of moving towards giving UK firms some confidence of what sort of trade terms the UK is likely to have with the EU from 2019. It has to be said that overall, this is really a quite pessimistic outlook for the UK economy.

## Interest Rate Forecast

The Council's treasury advisor, 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
BANK RATE	0.50	0.50	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00
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
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
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
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

The predicted interest rate forecast from our treasury management advisors, Capita, is that interest rates will remain at 0.5% up to September 2018 and then in December 2018 the base rate is predicted to rise to 0.75%. By December 2019 the bank base rate is predicted to increase to 1%.

A Council is not able to borrow in advance of need and borrowing will be undertaken on review of the Council's whole Capital Financing Requirement and projected Balance Sheet for future years.

## Annual Investment Strategy

The Treasury Management Strategy Statement (TMSS) for 2017/18, which includes the Annual Investment Strategy, was approved by the Council on 11/04/17 – CM69 (and Audit Committee 21/03/2017 – AC32). It sets out the Council's investment priorities as being:

- Security of capital;
- Liquidity; and
- Yield.

The Council will also aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs, but also to seek out value available in periods up to 12 months with highly credit rated financial institutions, using our suggested creditworthiness approach, including a minimum sovereign credit rating, and Credit Default Swap (CDS) overlay information.

## Net Interest Position

	<b>2016/17 Outturn £</b>	<b>Sept-17 £</b>	<b>Estimated Outturn £</b>
<b>Interest paid</b>	95,550	47,775	95,550
<b>Interest earned</b>			
Investment interest	(55,113)	(8,410)	(45,000)
<b>Net Interest</b>	<b>40,437</b>	<b>39,365</b>	<b>50,550</b>
CCLA – LAPF Dividend			(21,000)
<b>Net Interest</b>	<b>40,437</b>	<b>39,365</b>	<b>29,550</b>

The Council made an investment in the CCLA's Property Fund on 30 April 2017. It should be noted that investments in property funds are a long term commitment which means that there can be fluctuations on the return from the investment.

## Treasury Position at 30 September 2017

### Money Market Funds

<b>Amount</b>	<b>Investment</b>	<b>Interest rate*</b>
£3,000,000	Ignis Sterling Liquidity	As below
£1,040,000	BlackRock ICS-Inst GBP	As below
£3,000,000	LGIM Sterling Liquidity Fund	As below

\*Interest rate is variable

The Council currently has four Money Market Funds. The money market funds allow immediate access to the Council's funds and spreads risk as it is pooled with investments by other organisations and invested across a wide range of financial institutions.

### Fixed Term Deposits - Current

<b>Amount</b>	<b>Investment</b>	<b>Interest rate</b>	<b>Date Invested</b>	<b>No of Days</b>
£3,000,000	Lloyds Bank Plc	0.55%	15/05/2017	184

### **Fixed Term Deposits – Forward Deals**

<b>Amount</b>	<b>Investment</b>	<b>Interest rate</b>	<b>Date Invested</b>	<b>No of Days</b>
£3,000,000	Lloyds Bank Plc	0.65%	15/11/2017	184

The Council's Investments mid way through the year are always higher than at the end of the year (at 31st March) due to the cashflow advantage that the Council benefits from part way through the year.

This is, in part, due to the timing differences between the Council collecting council tax income and paying this over to major precepting authorities such as Devon County Council, the Police and the Fire Authority

The Council's current counterparty limit is £3 million (£4 million for Lloyds plc).

### **Property Funds**

<b>Amount</b>	<b>Investment</b>	<b>Dividend Yield</b>
£500,000	CCLA – Property Fund	4.60%

### **Performance Assessment and Proposed Way Forward**

The Council's budget for investment interest of £70,321 for 2017/18 is expected to be on target. This takes into account current performance and the base rate rise on 2 November 2017.

Industry performance is judged and monitored by reference to a standard benchmark; this is the 7 day London Interbank Bid Rate (LIBID). The average weighted LIBID rate at the end of September was 0.11% which is 0.27% lower than our average return of 0.38% as at 30 September 2017.

The Treasury Management Strategy is risk averse with no investments allowed for a period of more than a year and very high credit rating is required together with a limit of £3m per counterparty. This has resulted in only a small number of institutions in which we can invest (see Appendix A).

## Compliance with Treasury Limits and Prudential Indicators

During the financial year the Council has operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Policy Statement and annual Treasury Strategy Statement. The Council's Prudential Indicators for 2017/18 are detailed and shown in Appendix B.

### 3. Outcomes/outputs

In the last 18 months the interest achieved has been above the industry benchmark due to better use of fixed term investments. The budget for investment income for 2017/18 has been set at £70,321. This is £25,000 higher than in 2016/17, due to predicted income from the investment in CCLA in 2017/18.

### 4. Implications

Implications	Relevant to proposals Y/N	Details and proposed measures to address
Legal/Governance	Y	Statutory powers are provided by the Local Government Act 1972 Section 151 and the Local Government Act 2003
Financial	Y	To date, the Council has outperformed the industry benchmark by 0.27%. The Council has achieved a rate of return of 0.38%, against the 7 day LIBID bid rate (LIBID) of 0.11%. The Council is predicting that the investment income target of £70,321 will be met in 2017/18.
Risk	Y	<p>The security risk is the risk of failure of a counterparty. The liquidity risk is that there are liquidity constraints that affect the interest rate performance. The yield risk is regarding the volatility of interest rates/inflation.</p> <p>The Council has adopted the CIPFA Code Of Practice for Treasury Management and produces an Annual Treasury Management Strategy and Investment Strategy in accordance with CIPFA guidelines.</p> <p>The Council engages a Treasury Management advisor and a prudent view is always taken regarding future interest rate movements. Investment interest income is reported quarterly to SLT and the Audit Committee.</p>

Comprehensive Impact Assessment Implications		
Equality and Diversity	N	N/A
Safeguarding	N	N/A
Community Safety, Crime and Disorder	N	N/A
Health, Safety and Wellbeing	N	N/A
Other implications	N	None

### **Supporting Information**

#### **Appendices:**

Appendix A – Lending list as at 30 September 2017

Appendix B – Prudential and Treasury Indicators 2017/18

#### **Background Papers:**

Annual treasury strategy in advance of the year (Audit 21/03/17 – AC32)



## **APPENDIX A**

**West Devon Borough Council lending list as at 30 September 2017.**

<b>Barclays Bank Plc</b>
<b>HSBC Bank plc</b>
<b>Lloyds Banking Group Plc:</b> <ul style="list-style-type: none"><li>• Bank of Scotland plc</li><li>• Lloyds Bank plc</li></ul>
<b>Nationwide Building Society</b>
<b>Royal Bank of Scotland Group Plc:</b> <ul style="list-style-type: none"><li>• The Royal Bank of Scotland plc</li><li>• National Westminster Bank plc</li></ul>
<b>Government UK Debt Management Facility</b>
<b>Local Authorities (as defined under Section 23 of the Local Government Act 2003)</b>
<b>AAA rated Money Market Funds</b>
<b>AAA Enhanced Cash Funds</b>
<b>Property Investment Funds - CCLA</b>

## APPENDIX B

### PRUDENTIAL INDICATORS

#### THE CAPITAL PRUDENTIAL INDICATORS

The Council's capital expenditure plans are the key driver of treasury management activity. The outputs of the capital expenditure plans are reflected in prudential indicators, which are designed to assist members to overview and confirm capital expenditure plans.

#### Capital Expenditure.

This prudential Indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle.

Capital Expenditure	2015/16	2016/17	2017/18	2018/19	2019/20
	Actual £000	Actual £000	Estimate £000	Estimate £000	Estimate £000
<b>Total</b>	<b>300</b>	<b>651</b>	<b>41,970</b>	<b>901</b>	<b>3,151</b>

The capital expenditure estimates have been increased by £37.45 million in 2017/18 in line with the commercial property acquisition strategy. Similarly estimates for 2019/20 have been increased by £2.55 million for the Residential Property Purchase (HC 53).

Note: The Council has not yet purchased any commercial property at the time of writing this report but the table reflects the approved strategy.

The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

The table below summarises the above capital expenditure plans and how these plans are being financed. Any shortfall of resources results in a funding need (borrowing).

Capital Expenditure	2015/16	2016/17	2017/18	2018/19	2019/20
	Actual £000	Actual £000	Estimate £000	Estimate £000	Estimate £000
<b>Total</b>	<b>300</b>	<b>651</b>	<b>41,970</b>	<b>901</b>	<b>3,151</b>
<b>Financed by:</b>					
Capital receipts	32	0	0	0	0
Capital grants	244	239	402	402	402
Reserves	24	0	80	0	0
New Homes Bonus	0	412	88	199	199
<b>Net financing need for the year</b>	<b>Nil</b>	<b>Nil</b>	<b>41,400</b>	<b>300</b>	<b>2,550</b>

### **The Council's Borrowing Need (the Capital Financing Requirement)**

The second prudential indicator is the Council's Capital Financing Requirement (CFR). It is essentially a measure of the Council's underlying need to borrow if the figure is greater than zero.

In 2016/17 the Council has agreed to undertake prudential borrowing for the new leisure contract. The Council has also agreed borrowing for the waste fleet vehicles.

The Capital Financing Requirement has been increased by £37.45 million in 2017/18 to reflect the recommendations within the commercial property acquisition strategy. Note: The Council has not yet purchased any commercial property at the time of writing this report, but the table reflects the approved strategy.

	2015/16	2016/17	2017/18	2018/19	2019/20
	Actual £000	Actual £000	Estimate £000	Estimate £000	Estimate £000
<b>Capital Financing Requirement (CFR)</b>					
<b>Total CFR</b>	1,757	1,715	43,073	42,610	44,375
<b>Movement in CFR</b>	-42	-42	41,358	-463	1,765
<b>Movement in CFR represented by:</b>					
<b>Net Financing need for the year</b>	0	0	41,400	300	2,550
<b>Less MRP and other financing movements</b>	-42	-42	-42	-763	-785
<b>Net borrowing requirement</b>	-42	-42	41,358	-463	1,765

## Minimum Revenue Provision (MRP)

The MRP Policy Statement aims to ensure that the provision for the repayment of borrowing which financed the acquisition of an asset should be made over a period bearing some relation to that over which the asset continues to provide a service.

The MRP policy adopted is as below:-

<b>Borrowing</b>	<b>MRP Methodology</b>
Commercial Property acquisition (Borrowing of up to £37.45 million) Residential Property Purchase	<b><i>Annuity Method (over the 50 years)</i></b> Under this calculation, the revenue budget bears an equal annual charge (for principal and interest) over the life of the asset by taking into account the time value of money. Since MRP only relates to the 'principal' element, the amount of provision made annually gradually increases during the life of the asset. The interest rate used in annuity calculations will be referenced to prevailing average PWLB rates. Under this example, the MRP charge in Year 1 on a £37.45 million borrowing would be £367,000, this rises to £377,000 in Year 2 etc.
Waste Fleet, Leisure Investment and Kilworthy Park	<b><i>Asset Life Method</i></b> MRP is charged using the Asset Life method – based on the estimated life of the asset.  This option provides for a reduction in the borrowing need over approximately the asset's life.

## Debt Rescheduling

The Council has one PWLB loan of £2.1 million which matures in 2053; this is at a rate of 4.55%.

The Council has not undertaken any debt rescheduling during the first six months of 2017/18 and there are no current opportunities for debt rescheduling.

## **AFFORDABILITY PRUDENTIAL INDICATORS**

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances.

### **Ratio of financing costs to net revenue stream**

This indicator identifies the trend in the receipt of net investment income against the net revenue stream. It is calculated by dividing investment income and interest received by the Council's Net Budget Requirement.

The financing costs have been increased to reflect the proposals within the commercial property acquisition strategy. These proposals have increased this indicator in 2018/19 and 2019/20.

	2015/16	2016/17	2017/18	2018/19	2019/20
	Actual	Actual	Estimate	Estimate	Estimate
Ratio of net investment income to net revenue stream. (Surplus)	1.1%	1.1%	3.4%	26.7%	27.9%

### **Estimates of the incremental impact of capital investment decisions on council tax**

This indicator calculates the notional cost of the impact of lost investment income on the Council Tax, from spending capital resources.

The estimates of the impact on council tax (this is a notional indicator) have been revised for the proposals set out in the commercial property acquisition strategy.

The commercial property acquisition strategy has the potential to contribute to the forecast budget gap by £520,000 as set out in the report. If the borrowing for the Waste Fleet and for Leisure are excluded, the expected benefit from the commercial property acquisition strategy would equate to a benefit of (£3.70) in 2017/18, rising to (£25.80) in 2018/19 and (£23.17) in 2019/20.

These figures are the incremental impact of capital investments decisions on a Band D council tax (surplus). These figures are included within the 'future incremental impact of capital investment decisions on the Band D Council Tax' shown below.

The cost shown in 2017/18 of £1.96 and in 2019/20 of £0.36 are due to the fact that the financing costs and MRP costs of the waste fleet, leisure investment and residential property purchase are also included.

**Incremental impact of capital investment decisions on the band D council tax (Notional cost as explained above)**

	2015/16	2016/17	2017/18	2018/19	2019/20
	Actual	Actual	Estimate	Estimate	Estimate
	£	£	£	£	£
Future incremental impact of capital investment decisions on the band D Council tax (Notional cost)	0.01	0.06	1.96	(2.61)	0.36

**TREASURY INDICATORS: LIMITS TO BORROWING ACTIVITY**

**The Operational Boundary** – This is the limit beyond which external debt is not normally expected to exceed. This is the maximum level of external debt for cash flow purposes.

Operational Boundary	2015/16	2016/17	2017/18	2018/19
	£	£	£	£
Borrowing	3,000,000	3,000,000	45,000,000	47,500,000
Other long term liabilities	-	-	-	-
Total	3,000,000	3,000,000	45,000,000	47,500,000

**The Authorised Limit for External Debt** – A further key prudential indicator represents a control on the overall level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by Full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

This provides headroom over and above the operational boundary for unusual cash movements. This is the maximum amount of money that the Council could afford to borrow.

This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although no control has yet been exercised.

The figures in 2017/18 have increased to reflect the proposed borrowing for the new leisure contract and potential additional borrowing for the waste fleet. The Operational Boundary has been increased by £37.45 million in 2017/18 to reflect the recommendations within the commercial property acquisition strategy. Similarly the limits in 2019/20 have been increased by £2.55 million for the residential property purchase (HC 53). Note: The Council has not yet purchased any commercial property at the time of writing this report, but the table reflects the approved strategy.

Authorised limit	2015/16	2016/17	2017/18	2018/19
	£	£	£	£
Borrowing	6,000,000	6,000,000	48,000,000	50,500,000
Other long term liabilities	-	-	-	-
Total	6,000,000	6,000,000	48,000,000	50,500,000

West Devon Borough Council's current level of external borrowing is £2.1 million.

The figures in 2017/18 have increased to reflect the proposed borrowing for the new leisure contract and potential additional borrowing for the waste fleet.

The Authorised Limit has been increased by £37.45 million in 2017/18 to reflect the recommendations within the commercial property acquisition strategy. Similarly the limits in 2019/20 have been increased by £2.55 million for the residential property purchase (HC 53).

Note: The Council has not yet purchased any commercial property at the time of writing this report, but the table reflects the approved strategy.