Report to:	**Audit Committee**
Date:	**31 January 2019**
Title:	**Treasury Management Mid-Year Review**
Portfolio Area:	**Support Services – Cllr S Wright**
Wards Affected:	**ALL**

Relevant Scrutiny Committee: Overview and Scrutiny Panel

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

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Recommendations:

That the contents of the report are endorsed.

1. Executive summary

To date, the Council has achieved the industry benchmark. The Council has achieved a rate of return of 0.59%, against the 7 day LIBID bid rate (LIBID) of 0.59%. The Council's budget for investment interest of £123,000 for 2018/19 is expected to be above target by £70,000. This is due to a number of factors; the recent investment with the CCLA (£30,000), higher than anticipated interest rates, and improved use of fixed term deals with the banks currently on the Council's counterparty list.

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.

In July 2016, the Council approved to undertake prudential borrowing of up to £6.337 million for the new leisure contract (Minute 33/16), with borrowing of £5.49 million already been undertaken in May 2018.

In September 2018, the Council approved the Commercial Property Strategy, which enables the Council to borrow up to £60 million (capped at no more than £30 million before 30 April 2019).

At Council in March 2018, it was approved (Minute 74/17) that a sum of £500,000 be used to invest into the CCLA Local Authority Property Fund and £1 million into the CCLA Diversified Income Fund, with the investments being placed in May 2018.

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/Executive three times a year on Treasury Management. The specific reporting requirements are:

An annual treasury strategy in advance of the year (Executive 15/03/18 - E72-17)
A mid-year 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

The first half of 2018/19 has seen UK **economic growth** post a modest performance, but sufficiently robust for the Monetary Policy Committee, (MPC), to unanimously (9-0) vote to increase **Bank Rate** on 2nd August from 0.5% to 0.75%. Although growth looks as if it will only be modest at around 1.5% in 2018, the Bank of England's August Quarterly Inflation Report forecast that growth will pick up to 1.8% in 2019, albeit there were several caveats – mainly related to whether or not the UK achieves an orderly withdrawal from the European Union in March 2019.

Some MPC members have expressed concerns about a build-up of **inflationary pressures**, particularly with the pound falling in value again against both the US dollar and the Euro. The Consumer Price Index (CPI) measure of inflation rose unexpectedly from 2.4% in June to 2.7% in August due to increases in volatile components, but is expected to fall back to the 2% inflation target over the next two years given a scenario of minimal increases in Bank Rate. The MPC has indicated Bank Rate would need to be in the region of 1.5% by March 2021 for inflation to stay on track. Financial markets are currently pricing in the next increase in Bank Rate for the second half of 2019. However, the MPC will need to tread cautiously before increasing Bank Rate again, especially given all the uncertainties around Brexit.

Interest Rate Forecast

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

Link Asset Services Interest Rate View											
	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate View	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%
3 Month LIBID	0.75%	0.80%	0.80%	0.90%	1.10%	1.10%	1.20%	1.40%	1.50%	1.60%	1.60%
6 Month LIBID	0.85%	0.90%	0.90%	1.00%	1.20%	1.20%	1.30%	1.50%	1.60%	1.70%	1.70%
12 Month LIBID	1.00%	1.00%	1.00%	1.10%	1.30%	1.30%	1.40%	1.60%	1.70%	1.80%	1.80%
5yr PWLB Rate	2.00%	2.00%	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%
10yr PWLB Rate	2.40%	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%
25yr PWLB Rate	2.80%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.50%	3.50%
50yr PWLB Rate	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%

The flow of generally positive economic statistics after the end of the quarter ended 30 June meant that it came as no surprise that the MPC came to a decision on 2 August to make the first increase in Bank Rate above 0.5% since the financial crash, to 0.75%. However, the MPC emphasised again, that future Bank Rate increases would be gradual and would rise to a much lower equilibrium rate, (where monetary policy is neither expansionary of contractionary), than before the crash; indeed they gave a figure for this of around 2.5% in ten years' time but they declined to give a medium term forecast. We do not think that the MPC will increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. We also feel that the MPC is more likely to wait until August 2019, than May 2019, before the next increase, to be followed by further increases of 0.25% in May and November 2020 to reach 1.5%. However, the cautious pace of even these limited increases is dependent on a reasonably orderly Brexit.

Annual Investment Strategy

The Treasury Management Strategy Statement (TMSS) for 2018/19, which includes the Annual Investment Strategy, was approved by the Council on 29/03/18 – minute 74/17 (and Executive 15/03/18 - E72-17). 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.

Debt and Investment Position

A summary of the Council's debt and investment position as at 30 September 2018 (including forecast as at 31 March 2019) compared with 31 March 2018 is shown in the table below.

Debt & Investments	**31 March 2018**		**30 September 2018**		**31 March 2019**	
	Actual		**Actual**		**Forecast**	
	£'000	**Rate %**	**£'000**	**Rate %**	**£'000**	**Rate %**
Long Term Debt:						
PWLB	-	-	5,490	2.41*	5,490	2.41*
Total Debt	**-**		**5,490**		**5,490**	
Investments:						
Short term - fixed	22,600	0.32	18,800	0.59	18,000	0.59
Money Market Funds	20,140	0.26	22,590	0.52*	16,000	0.52*
CCLA Funds	-	-	1,500	3.68*	1,500	3.68*
Heritable Bank	22	-	22	-	22	-
Total Investments	**42,762**		**42,912**		**35,522**	
Net Borrowing Position	**(42,762)**		**(37,422)**		**(30,032)**	

*Average interest rate

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.

Treasury Position as at 30 September 2018

Money Market Funds

Amount	Investment	Interest rate*
£6,000,000	Ignis Sterling Liquidity	0.52%
£6,000,000	BlackRock ICS-Inst GBP	0.54%
£6,000,000	LGIM Sterling Liquidity Fund	0.55%
£4,590,000	Deutsche Asset Management	0.46%

*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

Counterparty	Fixed to	£	Interest Rate
Nationwide BS	08/10/2018	5,000,000	0.73%
Nationwide BS	09/12/2018	1,000,000	0.60%
Lloyds Bank	04/07/2019	5,000,000	1.00%
Lloyds Bank	02/08/2019	1,000,000	1.00%
Barclays Bank	05/11/2018	2,500,000	0.69%
Barclays Bank	19/03/2019	3,500,000	0.80%
Debt Management Office (See Note * below)	19/10/2018	800,000	0.51%

* Note

This investment was taken out on 17th September (when the direct debit income from council tax and business rates was received) and was for a short term period of one month. The current counter-party limits were already reached for Barclays, Nationwide and Lloyds. The investment was structured to mature on the day that the precepts were due to be paid to the major precepting authorities.

The Council's current counterparty limit is £6 million (£7 million for Lloyds plc).

Fixed Term Deposits – Forward Deals

Amount	Investment	Interest rate	Date Invested	No of Days
£2,500,000	Barclays Bank	0.85%	05/11/2018	182
£5,000,000	Nationwide BS	0.72%	09/10/2018	182
£1,000,000	Nationwide BS	0.77%	19/12/2018	182
£3,800,000	Debt Management Office	0.50%	02/01/2018	19

CCLA Funds

Amount	Investment	Dividend Yield
£500,000	CCLA – Property Fund	4.27%
£1,000,000	CCLA - Diversified Income Fund (Class 2)	3.09%

Performance Assessment and Proposed Way Forward

The Council's budget for investment interest of £123,000 for 2018/19 is expected to be above target by £70,000. This is due to a number of factors; the recent investment with the CCLA (£30,000), higher than anticipated interest rates, and improved use of fixed term deals with the banks currently on the Council's counterparty list.

Industry performance is judged and monitored by reference to a standard benchmark; this is the 7 day London Interbank Bid Rate (LIBID). The Council achieved the average weighted LIBID rate at the end of September of 0.59%.

The Treasury Management Strategy is risk averse with no investments allowed for a period of more than a year and very high credit rating are required, together with a limit of £6m 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 2018/19 are detailed and shown in Appendix B.

3. Outcomes/outputs

Over the last 2 years the Council's investment interest has achieved or exceeded the industry benchmark due to better use of fixed term investments and Money Market Funds.

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 achieved a rate of return of 0.59%, against the 7 day LIBID bid rate (LIBID) of 0.59%. The Council's budget for investment income of £123,000 for 2018/19 is expected to be above target by £70,000.
Risk	Y	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. 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. 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 Executive.
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 2018
Appendix B – Prudential and Treasury Indicators 2018/19

Background Papers:

Annual treasury strategy in advance of the year (Executive 15/03/18 - E72-17)

APPENDIX A

Counterparty as at 28th September 2018		Fitch Rating					Moody's Ratings			S&P Ratings			
United Kingdom		Long Term		Short Term	Viability	Support	Long Term		Short Term	Long Term		Short Term	Suggested Duration
	Collateralised LA Deposit*												Y - 60 mths
	Debt Management Office												Y - 60 mths
	Multilateral Development Banks												Y - 60 mths
	Supranationals												Y - 60 mths
	UK Gilts												Y - 60 mths
Banks	Abbey National Treasury Services PLC	SB	A	F1		1	SB	Aa3	P-1				R - 6 mths
	Bank of Scotland PLC (RFB)	SB	A+	F1	a	5	SB	Aa3	P-1	SB	A+	A-1	O - 12 mths
	Barclays Bank PLC (NRFB)	PW	A	F1	a	5	SB	A2	P-1	SB	A	A-1	R - 6 mths
	Barclays Bank UK PLC (RFB)	PW	A	F1	a	1	SB	A1	P-1	SB	A	A-1	R - 6 mths
	Close Brothers Ltd	SB	A	F1	a	5	SB	Aa3	P-1				R - 6 mths
	Goldman Sachs International Bank	SB	A	F1		1	NO	A1	P-1	SB	A+	A-1	R - 6 mths
	HSBC Bank PLC (NRFB)	SB	AA-	F1+	a+	1	SB	Aa3	P-1	SB	AA-	A-1+	O - 12 mths
	HSBC UK Bank PLC (RFB)	SB	AA-	F1+	a	1				SB	AA-	A-1+	O - 12 mths
	Lloyds Bank Corporate Markets Plc (NRFB)	SB	A	F1		1	SB	A1	P-1	SB	A	A-1	R - 6 mths
	Lloyds Bank Plc (RFB)	SB	A+	F1	a	5	SB	Aa3	P-1	SB	A+	A-1	O - 12 mths
	Santander UK PLC	PW	A	F1	a	2	SB	Aa3	P-1	SB	A	A-1	R - 6 mths
	Standard Chartered Bank	SB	A+	F1	a	5	SB	A1	P-1	SB	A	A-1	R - 6 mths
	Sumitomo Mitsui Banking Corporation Europe Ltd	SB	A	F1		1	SB	A1	P-1	PO	A	A-1	R - 6 mths
	UBS Ltd.	SB	AA-	F1+		1	SB	Aa3	P-1	SB	A+	A-1	O - 12 mths
Building Societies	Coventry Building Society	SB	A	F1	a	5	SB	A2	P-1				R - 6 mths
	Leeds Building Society	SB	A-	F1	a-	5	SB	A3	P-2				G - 100 days
	Nationwide Building Society	SB	A	F1	a	5	SB	Aa3	P-1	PO	A	A-1	R - 6 mths
	Skipton Building Society	SB	A-	F1	a-	5	PO	Baa1	P-2				G - 100 days
	Yorkshire Building Society	SB	A-	F1	a-	5	SB	A3	P-2				G - 100 days
Nationalised and Part Nationalised Banks	National Westminster Bank PLC	PO	A-	F2	bbb+	5	PO	A1	P-1	PO	A-	A-2	B - 12 mths
	Royal Bank of Scotland Group Plc	PO	BBB+	F2	bbb+	5	PO	Baa2	P-2	PO	BBB-	A-3	B - 12 mths
	The Royal Bank of Scotland Plc	PO	A-	F2	bbb+	5	PO	A1	P-1	PO	A-	A-2	B - 12 mths

Key

Watches and Outlooks		Duration	
SB	Stable Outlook	Yellow - Y	60 Months
NO	Negative Outlook	Blue - B	12 Months
NW	Negative Watch	Orange - O	12 Months
PO	Positive Outlook	Red - R	6 Months
PW	Positive Watch	Green - G	100 Days
EO	Evolving Outlook		
EW	Evolving Watch		

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	2017/18 Actual £000	2018/19 Original Estimate £000	2018/19 Revised Estimate £000
Total	**4,179**	**7,492**	**8,932**

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.

Capital Expenditure	2017/18 Actual £000	2018/19 Original Estimate £000	2018/19 Revised Estimate £000
Total	**4,179**	**7,492**	**8,932**
Financed by:			
Capital receipts	1,212	1,111	852
Capital grants	1,079	700	700
Reserves	1,144	326	1,556
New Homes Bonus		418	30
S106			272
Net financing need for the year	**744**	**4,937**	**5,522**

Nb. Please note that the original estimate for 2018-19 represents the approved capital programme for that year. However, the revised estimate includes not only expenditure on projects within that capital programme, but also expenditure on schemes carried forward from previous capital programmes.

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 July 2016 (Minute 33/16) the Council agreed to undertake prudential borrowing of up to £6.337 million for the new leisure contract, with borrowing of £5.49 million already undertaken in May 2018.

	2018/19 Original Estimate £000	2018/19 Revised Estimate £000
Total CFR	5,797	6,168
Movement in CFR	4,857	5,522
Explained by:		
Minimum Revenue Provision	(40)	0
Change in underlying need to borrow	4,897	5,522

For capital expenditure incurred since 1.4.2008, MRP is charged using the Asset Life method – based on the estimated life of the asset (For the Leisure investment, MRP will be charged over the 25 years – therefore 4% per annum). MRP will be charged in the year following the asset becoming operational. For the Leisure investment this will be 2019/20 and therefore no MRP has been included in the revised estimate.

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:-

Borrowing	**MRP Methodology**
Leisure Investment	**Asset Life Method** MRP is charged using the Asset Life method – based on the estimated life of the asset. (For the Leisure investment, MRP will be charged over the 25 years – therefore 4% per annum). This option provides for a reduction in the borrowing need over approximately the asset’s life.

Debt Rescheduling

The Council has not undertaken any debt rescheduling during the first six months of 2018/19 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 were increased in the 2018/19 original estimate to reflect the cost of borrowing for the Leisure investment.

	2017/18	2018/19	2018/19
	Actual	Original Estimate	Revised Estimate
Ratio of net investment income to net revenue stream. (Surplus)	(1.7)%	1.0%	(1.4)%

TREASURY INDICATORS: LIMITS TO BORROWING ACTIVITY

(as per the 2018-19 Treasury Management Strategy approved by Council in March 2018)

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	2017/18	2018/19	2019/20	2020/21
	£	£	£	£
Borrowing	5,000,000	9,000,000	10,000,000	10,000,000
Other long term liabilities	-	-	-	-
Total	5,000,000	9,000,000	10,000,000	10,000,000

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.

Authorised limit	**2017/18**	**2018/19**	**2019/20**	**2020/21**
	£	**£**	**£**	**£**
Borrowing	10,000,000	14,000,000	15,000,000	15,000,000
Other long term liabilities	-	-	-	-
Total	10,000,000	14,000,000	15,000,000	15,000,000

South Hams District Council's current level of external borrowing is £5.49 million.