Report to:	**Executive**
Date:	**7 December 2017**
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:

1. That the contents of the report are endorsed.

1. Executive summary

To date, the Council has outperformed the industry benchmark by 0.13%. The Council has achieved a rate of return of 0.24%, against the 7 day LIBID bid rate (LIBID) of 0.11%. However the Council is forecasting a shortfall in investment income of £20,000 against its budgeted income target of £123,000. The Council is investigating alternative investment vehicles (which are longer term investments) in order to be able to reduce this cost pressure in the future.

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. The Council is currently debt-free although the Council has agreed to undertake prudential borrowing of £6.337 million for the new leisure contract (Minute 33/16). This is further explained in Appendix A.

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

An annual treasury strategy in advance of the year (Executive 09/03/17 - E73-16)
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

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%.

Officers will make recommendations in January 2018 on the strategy for internal borrowing and external borrowing for the Leisure Investment. 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 30/03/17 – minute 77/16 (and Executive 09/03/17 - E73-16). 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.

Treasury Position at 30 September 2017

	As at 31/03/2017		As at 30/09/2017	
Investment Type	**Principal £**	**Interest %**	**Principal £**	**Interest %**
Short Fixed	17,000,000	0.49	22,500,000	0.28
Money Market Funds	12,175,000	0.34	22,860,000	0.20
Heritable Bank	22,483	-	22,483	-
Total	**29,197,483**	**0.42***	**45,382,483**	**0.24***

**This denotes the average interest rate*

The Council's Investments mid way through the year are always higher than at the end of the year (31 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 the major precepting authorities such as Devon County Council, the Police and the Fire Authority.

The following is a list of our fixed investments at 30 September 2017:

Counterparty	Fixed to	£	Interest Rate
Barclays Bank plc	02/11/2017	2,500,000	0.37%
Barclays Bank plc	19/03/2018	3,500,000	0.37%
Nationwide BS	19/12/2017	1,000,000	0.36%
Nationwide BS	06/04/2018	5,000,000	0.32%
Lloyds TSB Bank Plc	04/01/2018	5,000,000	0.36%
Lloyds TSB Bank Plc	02/02/2018	1,000,000	0.36%
Debt Management Office (See Note * below)	20/10/2017	2,000,000	0.10%
Debt Management Office (See Note * below)	20/10/2017	2,500,000	0.10%

<u>* Note</u>

These investments were taken out on 15th August and 1st September respectively (when the direct debit income from council tax and business rates was received) and were for a short term period of two months. 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).

Icelandic Bank

The Council placed a deposit of £1,250,000 on 25th September 2008 with the Heritable Bank which is a subsidiary of Landsbanki, one of the Icelandic Banks that was affected by the world economic crisis. Of this amount £1,227,517 (98%) has already been repaid to the Council by the Administrators. At the 30 September 2017, the Council had £22,483 frozen in the Heritable Bank.

At the time the deposit was placed, the risk rating of Heritable was 'A' (long term deposits) and F1 (short term deposits). Both ratings indicated low risk and were within the deposit policy approved by the Council. Heritable Bank is registered in Scotland with an address in Edinburgh. Heritable Bank Plc is authorised and regulated by the Financial Services Authority and is on the FSA Register. The bank's shares are owned by Icelandic bank, Landsbanki.

Administrators have kept the bank trading and are winding down the business over a period of years. The Administrators have paid fifteen dividends amounting to 98% of the original deposit. The administrators estimate that the return to all unsecured creditors is now between 98-100 pence in the pound.

Performance Assessment and Proposed Way Forward

To date, the Council has outperformed the industry benchmark by 0.13%. The Council has achieved a rate of return of 0.24%, against the 7 day LIBID bid rate (LIBID) of 0.11%. However the Council is forecasting a shortfall in investment income of £20,000 against its budgeted income target of £123,000. The Council is investigating alternative investment vehicles (which are longer term investments) in order to be able to reduce this cost pressure in the future.

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 0.13% lower than our average return of 0.24% @30/09/17. The reason the Council is exceeding this benchmark is due to the use of fixed term investments that where made before the Bank of England dropped the base rate (4th August 2016) so when they are renewed the return will be lower.

The Members' Budget Workshop included a proposal for the Council to invest some of its funds in the CCLA Property Fund (returns can be in the region of 5% - this is a longer term investment as this is effectively tying the investment up for at least 5 years). More modelling work is required on this option and this is linked to the work regarding officers making recommendations in January 2018 on the strategy for internal borrowing and external borrowing for the Leisure Investment.

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 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.

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 0.13%. The Council has achieved a rate of return of 0.24%, against the 7 day LIBID bid rate (LIBID) of 0.11%. However the Council is forecasting a shortfall in investment income of £20,000 against its budgeted income target of £123,000. The Council is investigating alternative investment vehicles (which are longer term investments) in order to be able to reduce this cost pressure in the future.
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 2017
Appendix B – Prudential and Treasury Indicators 2017/18

Background Papers:

Annual treasury strategy in advance of the year (Executive 09/03/17 - E73-16)

Approval and clearance of report

Process checklist	Completed
Portfolio Holder briefed	**Yes**
SLT Rep briefed	**Yes**
Relevant Exec Director sign off (draft)	**Yes**
Data protection issues considered	**Yes**
If exempt information, public (part 1) report also drafted. (Cabinet/Scrutiny)	**N/A**

APPENDIX A

South Hams District Council lending list as at 30th September 2017.

Barclays Bank Plc
HSBC Bank plc
Lloyds Banking Group Plc: • Bank of Scotland plc • Lloyds Bank plc
Nationwide Building Society
Royal Bank of Scotland Group Plc: • The Royal Bank of Scotland plc • National Westminster Bank plc
Government UK Debt Management Facility
Local Authorities (as defined under Section 23 of the Local Government Act 2003)
AAA rated Money Market Funds
AAA Enhanced Cash Funds

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
Total	**4,357**	**3,023**	**5,015***	**TBA**	**TBA**

*Note – This figure is £2,415,000 as per the Council report on 9 February 2017, plus £2.6 million for Leisure Investment in 17/18. In July 2016 (Minute 33/16) the Council agreed to undertake prudential borrowing of £6.337 million for the new leisure contract. The remaining leisure investment occurs in 18/19 and 19/20.

Officers will make recommendations in January 2018 on the strategy for internal borrowing and external borrowing for the Leisure Investment. 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.

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	2015/16	2016/17	2017/18	2018/19	2019/20
	Actual £000	Actual £000	Estimate £000	Estimate £000	Estimate £000
Total	**4,357**	**3,023**	**5,015**	**TBA**	**TBA**
Financed by:					
Capital receipts	1,087	665	877	**TBA**	**TBA**
Capital grants	764	1,166	613	**TBA**	**TBA**
Reserves	2,506	1,192	925	**TBA**	**TBA**
Net financing need for the year	**Nil**	**Nil**	**2,600**	**Nil**	**Nil**

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 £6.337 million for the new leisure contract. There is predicted to be £2.6 million of Leisure investment in 2017/18 (this is shown in the movement in CFR). The remaining leisure investment occurs in 18/19 and 19/20.

	2015/16 Actual £000	2016/17 Actual £000	2017/18 Estimate £000	2018/19 Estimate £000	2019/20 Estimate £000
Capital Financing Requirement (CFR)					
Total CFR	- 98	- 98	2,502	6,798	7,318
Movement in CFR	Nil	Nil	2,600	4,296	520
Movement in CFR represented by:					
Net Financing need for the year	Nil	Nil	2,600	4,400	800
Less MRP	Nil	Nil	Nil	-104	-280
Net borrowing requirement	Nil	Nil	2,600	4,296	520

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).

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.

	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)	(1.8)%	(1.6)%	(1.0)%	0.8%	0.8%

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 Council is not undertaking any borrowing to fund its Capital Programme at present.

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)	0.30	0.07	0.36	TBC	TBC

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	2016/17	2017/18	2018/19	2019/20
	£	£	£	£
Borrowing	2,000,000	5,000,000	9,000,000	10,000,000
Other long term liabilities	-	-	-	-
Total	2,000,000	5,000,000	9,000,000	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	2016/17	2017/18	2018/19	2019/20
	£	£	£	£
Borrowing	7,000,000	10,000,000	14,000,000	15,000,000
Other long term liabilities	-	-	-	-
Total	7,000,000	10,000,000	14,000,000	15,000,000