

	<p align="center">Cabinet 15 January 2018</p>
	<p align="center">Report from the Chief Finance Officer</p>
<p>2017/18 Mid-Year Treasury Report</p>	

Wards Affected:	All
Key or Non-Key Decision:	Key
Open or Part/Fully Exempt:	Open
No. of Appendices:	2
Background Papers:	None
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1.0 Purpose of the Report

1.1 This report updates Members on recent treasury activity.

2.0 Recommendation(s)

2.1 Cabinet is asked to note the 2017/18 mid-year Treasury report, which has already been reviewed by the Audit Committee and is to be forwarded to the Council.

3.0 Detail

Background

3.1 The Council's Treasury Management Strategy is underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2011, which includes the requirement for determining a treasury strategy on the likely financing and investment activity for the forthcoming financial year.

3.2 The Code also recommends that Members are informed of Treasury Management activities at least twice a year. This report therefore ensures this

authority is embracing best practice in accordance with CIPFA's recommendations.

- 3.3 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."
- 3.4 In addition to reporting on risk management, the Code requires the Authority to report on any financial instruments entered into to manage treasury risks.

Economic Background

- 3.5 Growth in the UK economy has slowed in 2017 with both the US and Eurozone now growing at around twice that of the UK. The most recent estimate for UK GDP growth is 0.3% for Q2 with the Eurozone and US running at 0.6%. Arlingclose have advised that the outlook for the UK economy remains challenging to predict following the vote to leave the European Union. Mark Carney, Bank of England governor, after the decision to keep interest rates at 0.25%, referred to uncertainty around the Brexit process "*weighing on the decisions of businesses*".
- 3.6 One of the key drivers of the UK economy, consumer spending has weakened as the effects of inflation out pacing wages starts to take hold. The weakness of the pound has been source of inflationary pressure however our treasury advisors noted that it is unlikely to result in the tightening of monetary policy by the Bank of England with a view to minimise the effects of Brexit on economic activity.
- 3.7 Gilt yields have fluctuated in response to domestic and international events in the first half of the year. The movement in rates at which local authorities can borrow from the Public Works Loans Board (PWLB) on maturity loans is shown in the table below:

PWLB Rates

Period	March 2017	August 2017
1 year	1.0%	1.1%
5 year	1.5%	1.4%
10 year	2.1%	2.1%

- 3.8 The interest rate the Council receives on money market funds has fallen since the previous report and 12 month maturities with local authorities have fallen from 0.6% to 0.4%.

Debt Management

- 3.9 The Authority continues to qualify for borrowing at the 'Certainty Rate' (0.20% below the PWLB standard rate). This is reviewed on an annual basis and has been confirmed as applying until 31 October 2017.
- 3.10 Alternative sources of long term funding to long-dated PWLB borrowing are available, but the Council will continue to adopt a cautious and considered approach to funding from the capital markets. The affordability, simplicity and ease of dealing with the PWLB represents a strong advantage but the Council, due to its prudent policies and strong balance sheet, is in a position to consider alternatives, and will start to do so in order to finance the investment strategy. However, no new long term loans have needed to be raised so far this year as can be seen in the table below:

	Balance on 01/04/2017 £m	Debt repaid* £m	New Borrowing £m	Balance on 31/08/2017 £m
Short Term Borrowing	0	0	0	0
Long Term Borrowing	415	1.6	0	413.4
TOTAL BORROWING	415	1.6	0	413.4
Average Rate %	4.79	2.57		4.81

* £28.5m of the PWLB loans are referred to as EIP, whereby the Councils pays down the loans in half-yearly equal installments over the lifetime of the loan. The marginal increase in the average interest rate can be attributed to the Council paying back its EIP loans. This is because the EIP loans have a much lower interest average interest rate of 2.57% compared with the rest of the debt, which is 4.98%

- 3.11 Affordability remains an important influence on the Council's borrowing strategy. Moreover, any borrowing undertaken ahead of need would need to be invested in the money markets at rates of interest significantly lower than the cost of borrowing and involve credit risk. If interest rates seemed likely to rise in the short-term then this approach might need to be reviewed.
- 3.12 The use of internal resources in lieu of borrowing has continued to be the most cost effective means of funding capital expenditure. This has lowered overall treasury risk by reducing external debt and temporary investments. However this position will not be sustainable over the medium term and the Council will need to give careful consideration to its future capital programme and how this is financed. Borrowing options and the timing of such borrowing will continue to be assessed in conjunction with the Council's treasury advisor, Arlingclose.
- 3.13 The persistence of low interest rates means that it would be uneconomic to reschedule debt, because early retirement of the loan would incur a heavy penalty, to compensate the PWLB for having to lend the money on at lower rates. For example, the Council's most expensive loan is £3.05m at a rate of

8.875%, to repay it would cost £0.935m, a 30% premium on the value of the loan before the cost of re-financing. In short, the cost of re-financing our loans under the Government's approach means is not economical. This analysis might change if interest rates returned to historically normal levels.

Investment Activity

- 3.14 The Council gives priority to security and liquidity and aims to achieve a yield commensurate with these principles.

	Balance on 01/04/2017 £m	Investments Made £m	Investments Repaid £m	Balance on 31/08/2017 £m
Short Term Investments	167.3	499.9	492.1	175.1

- 3.15 There was a £7m upward movement in short-term investments. This is due to a natural pattern of growth in cash in the early part of the year as grant income is frontloaded. However, it is far lower than the £42m upward movement last year, as already purchases of properties (NAIL, PRS and HRA) is having a significant impact on our cashflows with over £25m spent to date. The remainder is made up of higher spend across the Capital Programme. £199m was the average amount of cash held in 2016/17.

- 3.16 The council has undertaken a preliminary analysis of its cash flows, examining the pace at which we are reducing our cash reserves, The analysis was based on forecast capital spend, incoming resources and seasonal variations. This resulted in a prediction that the council will need to borrow towards the end of 2018, limiting our ability to use financial products that generate higher financial returns, as they would require longer time horizons. The council is reviewing its borrowing options which may include short term loans, PWLB borrowing or market loans. The council will also consider the advice of our Treasury management advisors, Arlingclose prior to any borrowing decision being made.

- 3.17 Security of capital has been maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2017/18. New investments were made with the following classes of institutions:

- A- or above rated banks;
- AAA rated Money Market Funds;
- Other Local Authorities;

- 3.18 Counterparty credit quality was assessed and monitored with reference to Credit Ratings (the Council's minimum long-term counterparty rating of A- (or equivalent) across rating agencies Fitch, Standard & Poor's and Moody's); credit default swaps; GDP of the country in which the institution operates; the

country's net debt as a percentage of GDP; sovereign support mechanisms; potential support from a well-resourced parent institution; share price. There were two foreign banks on our Lending List, both Swedish (and, therefore, outside the Eurozone), conservatively run and with good ratings and strong financial figures.

- 3.19 All investments in banks and building societies are now undertaken by means of marketable instruments (Certificates of Deposit, CDs). This adds a measure of additional liquidity without sacrificing return, given our maturity limits.

Budgeted Income And Outturn

- 3.20 The Council's external interest budget for the year is £23.3m, and for investment income is £1.4m. The Council is unlikely to achieve the income figure, but this will be compensated for by lower borrowing costs than budgeted. The average cash balances, representing the Council's reserves and working balances, were £191m during the period to 31 August 2017.

- 3.21 The UK Bank Rate increased to 0.50% from 0.25% on 02 November 2017. Short-term money market rates have increased in response to this rise however rates are very low compared to historic rates.

Icelandic Bank Investment Update

- 3.22 £0.2m of the original £10m deposit remains outstanding. It is expected that a further distribution will be made but this depends on the result of litigation currently under way regarding a property investment.

LOBOs (Lender Option Borrower Options)

- 3.23 The Council has a market loan portfolio comprising a total value of £95.5m. Of this, £80.5m are LOBOs with the remaining £15m made up of fixed rate loans. As noted in the previous report, Arlingclose have advised us that some of our other lenders may consider giving up these rights. There was no further changes to the LOBO portfolio since the last update.

Compliance

- 3.24 Officers confirm that they have complied with its Prudential Indicators for 2017/18, which were set in February 2017 as part of the Council's Treasury Management Strategy Statement (TMSS). Details can be found in Appendix 1.
- 3.25 The Committee is asked to note that there was a minor breach of the limits defined in the Treasury Management Strategy. An extra £0.1m was accidentally invested in Blackrock Money Market Fund to take the balance above £10m. The error was promptly discovered and £0.1m was withdrawn from the fund the following day. An investigation into this breach concluded that an error in entry to the Logotech Treasury Management system was the cause. Training has been provided to officers involved in the treasury management process to ensure a recurrence of this issue does not occur again.

Summary

3.26 In compliance with the requirements of the CIPFA Code of Practice, this report provides Members with a summary report of the treasury management activity during the first half of 2017/18. As indicated in this report, none of the Prudential Indicators have been breached and a prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.

4.0 Financial Implications

4.1 These are covering in the report.

5.0 Legal Implications

5.1 There are no direct legal implications.

6.0 Equality Implications

6.1 No direct implications.

7.0 Consultation with Ward Members and Stakeholders

7.1 None.

8.0 Human Resources/Property Implications (if appropriate)

8.1 No direct implications.

Report sign off:

CONRAD HALL
Chief Finance Officer