Item No: 7.3	Classification: Open	Date: 29 November 2017	Meeting Name: Council Assembly
Report title:		Treasury Management – Mid-year Update 2017/18	
Wards or Groups affected:		All	
From:		Strategic Director of Finance and Governance	

RECOMMENDATIONS

1. That council assembly note this 2017-18 mid-year treasury management update report and that:

   i. all treasury management activity in the period was undertaken in compliance with the approved treasury management strategy and with the council's prudential indicators as shown in appendix one.

   ii. in the six months to 30 September 2017 the sum invested averaged £137m and the balance of investments at 30 September 2017 stood at £116m.

   iii. the balance on all loans at 30 September 2017 was £455m. Loans totalling £2.5m matured and were repaid as scheduled during the year, with a further £2.5m due to mature in the second half of 2017-18. No new borrowing or debt rescheduling was undertaken during the period.

   iv. as indicated as part of the capital monitoring report taken to cabinet on 19 September 2017, it is likely that external borrowing will be required in 2017-18 to finance the capital programme. Options to identify the most appropriate source of financing will be appraised by the strategic director of finance and governance in conjunction with the cabinet member for finance, modernisation and performance.

   v. The Treasury Strategy 2018-19 will be presented to council assembly in February 2018.

BACKGROUND INFORMATION

1. In compliance with the Local Government Act 2003, the council has adopted the Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management Code of Practice. The Code requires local authorities to determine an annual Treasury Management Strategy and, as a minimum, formally report on their treasury activities and arrangements to Council Assembly mid-year and after the year-end. In accordance with the fairer future council plan, within the prudential framework, the treasury strategy seeks to reflect the principle of "*spending money as if it were from our own pocket*".

2. The CIPFA Code provides the following objective with regard to treasury management:

"It is important that treasury management policies adequately reflect risk and in particular security, liquidity and yield risk, in that order of importance. No treasury management transaction is without risk and management of risks is the key purpose of the treasury management strategy."

3. The 2017-18 Treasury Management Strategy was approved by council assembly in February 2016. Under financial delegation all executive, managerial and operational decisions are the responsibility of the strategic director of finance and governance.

4. The council is exposed to financial risks from short term investments, existing external debt, as well as future borrowing requirements arising from the council's capital programme. The risks include potential losses from investments and increased borrowing costs from changing interest rates:

5. The key issues covered in this report are:

   i. Investment position and activity for the period.
   ii. External debt position and activity for the period.
   iii. Internal borrowing and future borrowing requirements.
   iv. Prudential indicators for 2017-18.

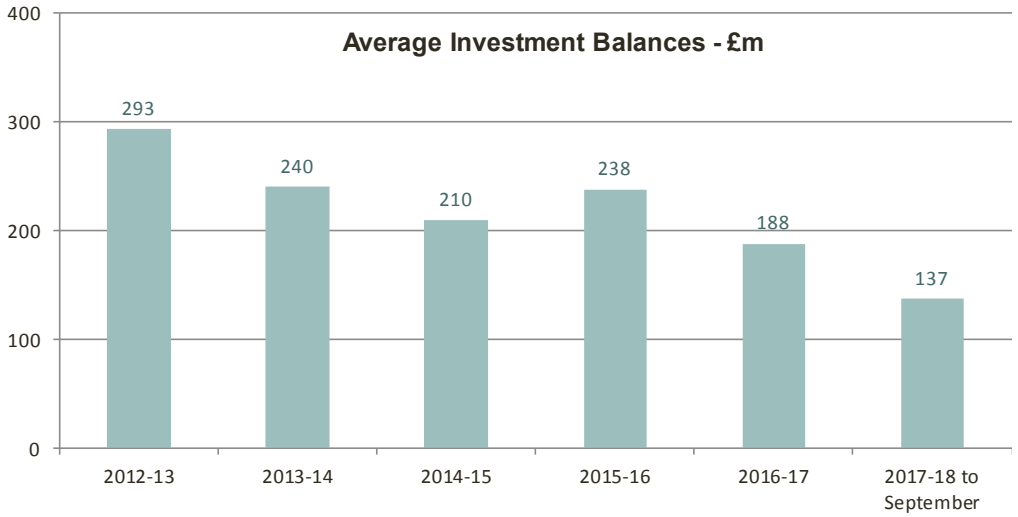
KEY ISSUES FOR CONSIDERATION

Investment position and activity for the period

6. The council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. Investments held at 30 September 2017 were £116m (£206m at 30 September 2016).

7. Council resources that are not immediately required for current expenditure are invested in money market instruments in accordance with the DCLG Guidance on Local Authority Investments and the approved investment strategy. The DCLG guidance gives priority to security and liquidity and the council's aim is to achieve a yield commensurate with these principles.

8. The overall level of investments held by the council has reduced over the previous five years as shown in the following graph. This is a consequence of the reduction in overall council reserves, continuation of internal borrowing policy, and the scheduled repayment of historical debt.



9. The half year return for council treasury management assets was 0.16%. The yield on short dated gilts, depressed as a result of additional monetary stimulus following the referendum on EU membership, remained persistently low for the first quarter of 2017-18 acting as a drag on investment returns.

10. UK Gilts sold off during the second quarter of 2017-18 as increasingly hawkish tones from the MPC led to greater speculation that a base rate rise would follow in the latter quarter of the calendar year. The negative impact on asset price valuations from an increase in yields further dampened investment performance for the year.

11. By way of a comparison, a composite benchmark of three month LIBID and one to three year gilt index returned -0.07% for the period leading to an outperformance of 0.23%; a solid relative, if not absolute, return.

12. The 2017-18 treasury strategy stipulates that no investment may be for a duration longer than five years and holdings beyond one year in duration are restricted to; government bonds, supranational bonds, quasi-sovereign bonds or covered bonds issued by major banks.

13. Council investments are managed both in-house and delegated to two fund managers: Alliance Bernstein and Aberdeen Asset Management. The focus for in-house investment is to meet variable near term cash liquidity requirements, principally using money market funds and, to a lesser extent, call accounts and term deposits diversified across major banks and building societies

14. The external fund managers invest over a longer term in UK government gilts, supranational bank bonds, and certificates of deposits issued by major banks/ building societies. The use of fund managers has the advantage of diversification of investment risk, coupled with the services of professional fund managers, which over the longer-term, provides enhanced returns within the council's risk appetite. Although investments can be redeemed from the fund managers at short notice, the intention is to hold them for the medium term. Their performance and suitability in meeting the council's investment objectives are regularly monitored.

15. The distribution of investments across counterparties, maturities and instruments at 30 September 2017 is set out in the table below:

	A		AA		AAA		Total
Investment Maturity	**£m**	**%**	**£m**	**%**	**£m**	**%**	**£m**
Up to 1 Year	24.5	21%	11.7	10%	51.9	45%	**88.1**
1 - 2 Years		0%	0.5	0%	9.8	9%	**10.3**
2 - 5 Years		0%	2.4	3%	15.0	13%	**17.4**
Total	**24.5**	**21%**	**14.6**	**13%**	**76.7**	**66%**	**115.8**

External debt management position and activity

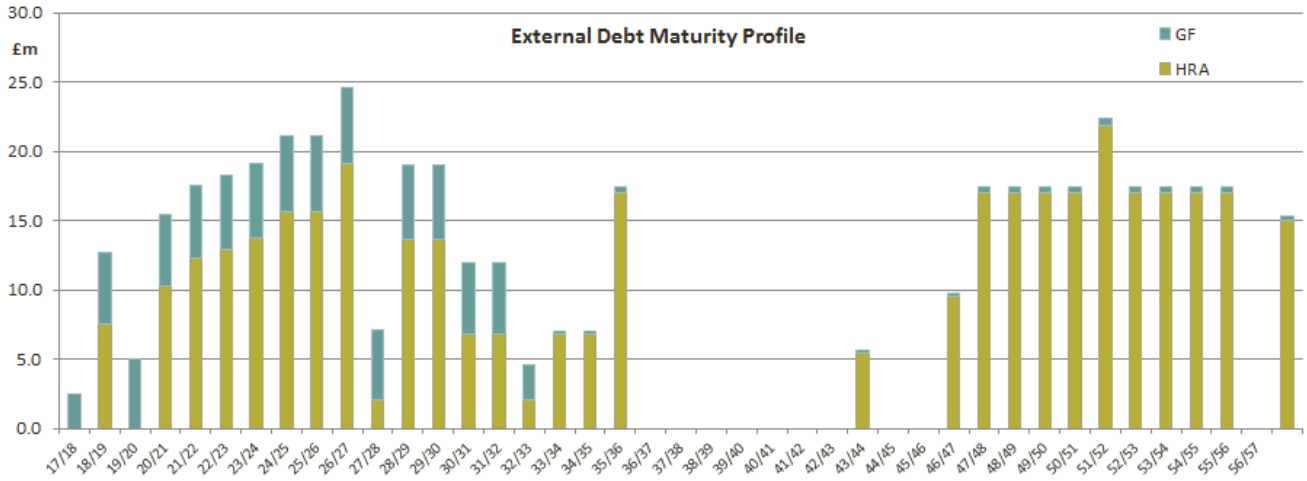
16. Capital expenditure for the council is financed through a variety of sources, typically receipts from the sale of capital assets, capital grants, external contributions, such as S106 or Community Infrastructure Levy (CIL), from reserves or from revenue budget contributions. Any capital expenditure that is not financed by the above will need to be financed by borrowing. Existing council debt is therefore the consequence of historical capital expenditure.

17. Current debt for the council is from the Public Works Loans Board (PWLB) an executive agency of HM Treasury. The debt balance outstanding as at 30 September was £455m (£460m as at September 2016) with £371m attributable to the HRA and £84m as attributable to the general fund.

18. The majority of existing debt is structured on a maturity basis such that the principal is repaid in full at the end of a fixed loan period. The exception is £100m debt drawn in 2012 on an equal instalment of principal basis. A fixed amount of principal (£5m) is repaid per year over the lifetime of these loans and forms the majority of the debt attributable to the General Fund, of which £75m remains as at 30 September 2017.

19. Each year, the General Fund sets aside sums known as the minimum revenue provision (MRP) to reduce its borrowing liabilities. In February 2017 council assembly approved an updated MRP strategy. The revised approach continues to make a prudent provision for the repayment of debt but now takes account of other factors, most notably affordability. The HRA may also set aside sums to reduce its own borrowing liabilities.

20. The maturity profile for all council debt is set out in the below chart split between the HRA and the GF.



21. The council is able to repay existing loans due to the PWLB in advance of scheduled maturity, but that this is accompanied by an additional premium on repayment. The additional cost for this repayment when assessed alongside the interest cost for drawing replacement debt has traditionally meant that this option is not financially beneficial to the council. Officers regularly monitor the prospective costs and benefits of early repayment and this opportunity will be further reviewed as part of the 2018-19 treasury strategy.

Internal borrowing and future borrowing decisions

22. The council began to pursue a policy of utilising existing cash and investment resources to meet capital and debt repayment obligations, rather than through external borrowing, during 2012 using existing resources to part fund the purchase of 160 Tooley St, alongside a significant debt refinancing.

23. The rationale for deferring the drawing of additional debt is that the use of short term cash resources to meet capital demands in lieu of borrowing allowed the authority to minimise external interest payments over the period from 2012-13.

24. Council investment balances are surplus resources that are earmarked for another purpose, typically reserves, provisions, S106 receipts, borrowing in advance of need or revenue expenditure. The use of balances, earmarked for other purposes, to fund capital expenditure is called 'internal borrowing'. This is because the organisation has funded current capital expenditure, which would otherwise have required external debt financing by using resources set aside for other future commitments.

25. The savings for the council from deferring external borrowing for the purchase of Tooley St equate to £20m for the five year period from 2012-13 to 2017-18 or £4m per annum.

26. The opportunity cost of a reduction in overall investment income, arising from lower cash balances, was more than offset by reduced external interest expenses. Throughout this period there has been a significant variance between income earned from short term investments and the expense incurred from longer duration debt.

27. Efficient use of existing council resources to fund capital expenditure through internal borrowing has also reduced the council's counterparty risk, the risk that a bank or other organisation is unable to repay funds the council has deposited.

28. The level of internal borrowing as at 31 March 2017 was £224m, split between £17m for the HRA and £207m for the GF. This increased by £26m from the previous financial year.

Future borrowing

29. As reported to cabinet on 19 September 2017 as part of the monitoring of capital programme budget, the indications are that the council would need to borrow in 2017-18 to finance the capital programme (Policy and Resources Strategy: Capital Monitoring report, including Capital Programme Update 2017-18 Month 4). The extent and timing of any external borrowing will depend upon short and medium cashflow forecasts for the council, in conjunction with consideration as to interest rate forecasts. Further, the strategic director of finance and governance will review the sustainability of the internal borrowing approach.

30. Officers regularly monitor current and forecast interest rates to determine the appropriateness of the current borrowing strategy, such that the reduction in current borrowing costs from use of internal balances, is not offset by higher borrowing costs in the future. Decisions with regard to

external borrowing will be made with the advice of the council's external treasury advisor, Arling Close.

Prudential indicators

31. The CIPFA codes set out a series of prudential indicators to support local authority capital financing, borrowing and investment activities. The indicators were last approved by council assembly in February 2017. The 2016-17 outturn indicators were reported to council assembly in July 2017 and an update to 2017-18 indicators is set out at appendix A.

32. The indicators include a self imposed authorised limit on debt, determined under the Local Government Act 2003. As well as loans, the limit accommodates long term liabilities (e.g. from the three PFI funded schools and the integrated waste reprocessing facility), capacity to replace internal borrowing with loans and borrow for very short periods if needed for re-finance within a risk controlled framework. The 2017-18 authorised limit is £1,205m and the council has remained within it. Over the six months to 30 September 2017 the actual debt and PFI liabilities totalled £558m.

SUPPLEMENTAL ADVICE FROM OTHER OFFICERS

Director of Law and Democracy

Treasury Management

34. The constitution determines that agreeing the treasury management strategy is a function of the council assembly and that review and scrutiny of strategies and policies is the responsibility of the audit, governance and standards committee.

35. Financial standing orders require the strategic director of finance and governance to set out the treasury management strategy for consideration and decision by council assembly, and report on activity on a regular basis to cabinet and at mid and year-end to council assembly. Furthermore all executive and operational decisions are delegated to the strategic director of finance and governance.

36. The Local Government Act 2003 ("the 2003 Act") and supporting regulations require local authorities to determine annual borrowing limits and have regard to the Prudential Code for Capital Finance, and the Treasury Management in the Public Services Code of Practice and Guidance, published by the Chartered Institute of Public Finance and Accountancy, when considering borrowing and investment strategies, determining or changing borrowing limits or prudential indicators.

37. Section 15(1) of the 2003 Act requires a local authority "to have regard (a) to such guidance as the Secretary of State may issue". This guidance is found in the Department of Communities and Local Government Guidance on Local Authority Investments updated March 2010 and there is statutory guidance on the Minimum Revenue Provision (MRP) made under section 21(1A) of the 2003 Act.

38. Section 12 of the 2003 Act grants local authorities the powers to invest for any purpose relevant to its functions or for the purposes of the prudent management of its financial affairs.

BACKGROUND DOCUMENTS

Background Papers	Held At	Contact
None.		

APPENDICES

No.	Title
Appendix A	Prudential Indicators 2017-18 Mid Year Update

AUDIT TRAIL

Lead Officer	Duncan Whitfield, Strategic Director of Finance and Governance	
Report Author	Fay Hammond, Department Finance Manager Corporate Finance	
Version	Final	
Version Date	16 November 2017	
Key Decision	Yes	
CONSULTATION WITH OTHER OFFICERS / DIRECTORATES / CABINET MEMBER		
Officer Title	**Comments Sought**	**Comments Included**
Director of Law and Democracy	Yes	Yes
Strategic Director of Finance and Governance	N/A	N/A
Cabinet Member	Yes	Yes
Final Report Sent to Constitutional team		16 November 2017