

TREASURY MANAGEMENT - QUARTER THREE

To: **General Purposes Committee**

Meeting Date: **27 March 2018**

From: **Chief Finance Officer**

Electoral division(s): **All**

Forward Plan ref: **Not applicable** *Key decision:* **No**

Purpose: **To provide the third quarterly update on the Treasury Management Strategy 2017-18, approved by Council in February 2017.**

Recommendation: **The General Purposes Committee is recommended to note the Treasury Management Report.**

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1. BACKGROUND

- 1.1 Treasury Management is governed by the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management (the Code). The Code has been developed to meet the needs of Local Authorities and its recommendations provide a basis to form clear treasury management objectives and to structure and maintain sound treasury management policies and practices.
- 1.2 The Code was adopted via the Treasury Management Strategy Statement (TMSS), which was approved by Council in February 2017. It requires the Council to produce an annual treasury report and a half yearly report. Alongside these, General Purposes Committee are also provided with quarterly updates on progress against the Strategy.
- 1.3 This report has been developed in consultation with the Council's external investment manager and treasury advisors, Link Asset Services (LAS), formerly Capita Asset Services and provides an update for the third quarter to 31st December 2017.

2. SUMMARY OF KEY HEADLINES

- 2.1 The main highlights for the quarter are:
 - Investment returns received on cash balances are in line or slightly below the benchmarks. A return of 0.28% was achieved compared to the 7 day and 3 month London Interbank Bid Rate (LIBID) benchmark (0.28%, 0.35% respectively). See section 6.
 - A £2,006k underspend is currently reported for the 3rd quarter, following an assessment of the annual minimum revenue provision (MRP) technical adjustments as reported in quarter 2. For further information please see Section 10.

3. THE ECONOMIC ENVIRONMENT

- 3.1 This information has been provided by Link Asset Services , the Council's treasury management advisors.
- 3.2 During the quarter ended 31st December 2017, the significant UK headlines of this analysis were:
 - The Monetary Policy Committee (MPC) increased Bank Rate by 0.25% to 0.50% at its November meeting;
 - Forward guidance from the MPC suggests two more 0.25% rises by 2020 but the risks to this forecast are dependent on the course of the Brexit negotiations during 2018;
 - Growth picked up to 0.4% in quarter 3 and is anticipated to reach 0.4% in quarter 4 meaning annual growth in 2017 will be in the range 1.7% – 1.8%, almost as strong as the recently upwardly revised figure for 2016 of 1.8%; and
 - Unemployment fell to 4.3% the lowest level since 1975

4. SUMMARY PORTFOLIO POSITION

4.1 A snapshot of the Council's debt and investment position is shown in the table below:

	TMSS Forecast March 2018 (as agreed by Council February 2017)		Actual as at 31 March 2017		Actual as at 31 st December 2017		Revised Forecast to March 2018	
	£m	Rate %	£m	Rate %	£m	Rate %	£m	Rate %
Long term borrowing								
PWLB	439.4	4.5	278.6	4.3	278.6	4.5	278.60	4.3
PWLB (3 rd Party Loans)	-		3.9	2.3	3.84	2.3	6.64	2.3
Market	-		45.0	4.0	45.0	4.0	45.00	4.0
LOBO	34.5	3.6	19.5	3.6	19.5	3.3	19.50	3.3
Total long term	473.9	4.3	347.0	4.3	346.9	4.3	349.74	4.3
Short term borrowing	-	-	92.0	0.4	120.0	0.5	120.0	0.5
Total borrowing	473.9	4.2	439.0	3.4	466.86	3.7	469.74	3.7
Investments	7.9	0.5	40.5	0.3	19.13	0.3	16.0	0.4
Total Net Debt / Borrowing	466.0	-	398.5	-	447.7	-	465.74	-
3rd Party Loans & Share Capital	-	-	4.3	-	4.24	-	7.04	-

4.2 Net debt at 31st December 2017 (£447.7m) is less than originally set out in the Treasury Management Strategy Statement in February 2017 (£466m). The full year projection shows that net debt as at 31st March (£465.7m) is forecast to be in line with the original TMSS estimate of (£466m). The forecast includes 3rd Party loans to Cambridgeshire Housing Investment Company (CHIC) of £2.8m (the first loan amount with further activity of this kind expected in the final quarter).

4.3 Further analysis of borrowing and investments is covered in the following two sections.

5. BORROWING

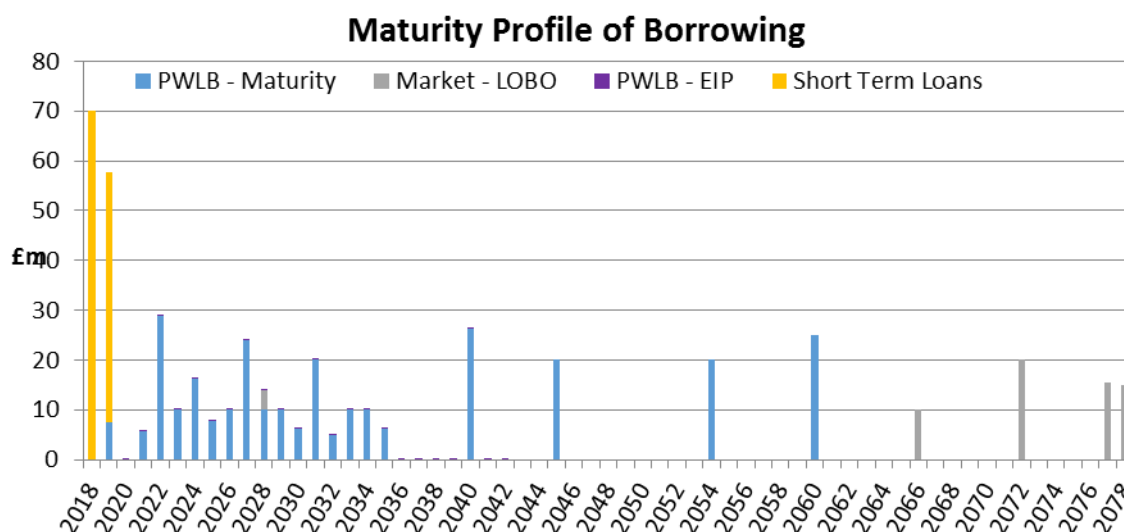
5.1 The Council can take out loans in order to fund spending for its Capital Programme. The amount of new borrowing required each year is determined by capital expenditure plans and projections of the Capital Financing Requirement, forecast reserves and current and projected economic conditions.

New loans and repayment of loans:

- 5.2 This section shows details of new long term (>1yr) loans raised and loans repaid during this quarter. No Loans were raised or repaid during the 3rd quarter to 31st December 2017.

Maturity profile of borrowing:

- 5.3 The following graph shows the maturity profile of the Council's loans. The majority of loans have a fixed interest rate and are long term which limits the Council's exposure to interest rate fluctuations. The weighted average years to maturity of the portfolio (assuming LOBO Loans run to maturity) is 18.7 years.
- 5.4 The presentation below differs from that in Treasury Indicator for maturity structure of borrowing in **Appendix 1** paragraph 4, in that the graph below includes LOBO loans at their final maturity rather than their next call date. In the current low interest rate environment the likelihood of the interest rates on these loans being raised and the loans requiring repayment at the break period is extremely low.

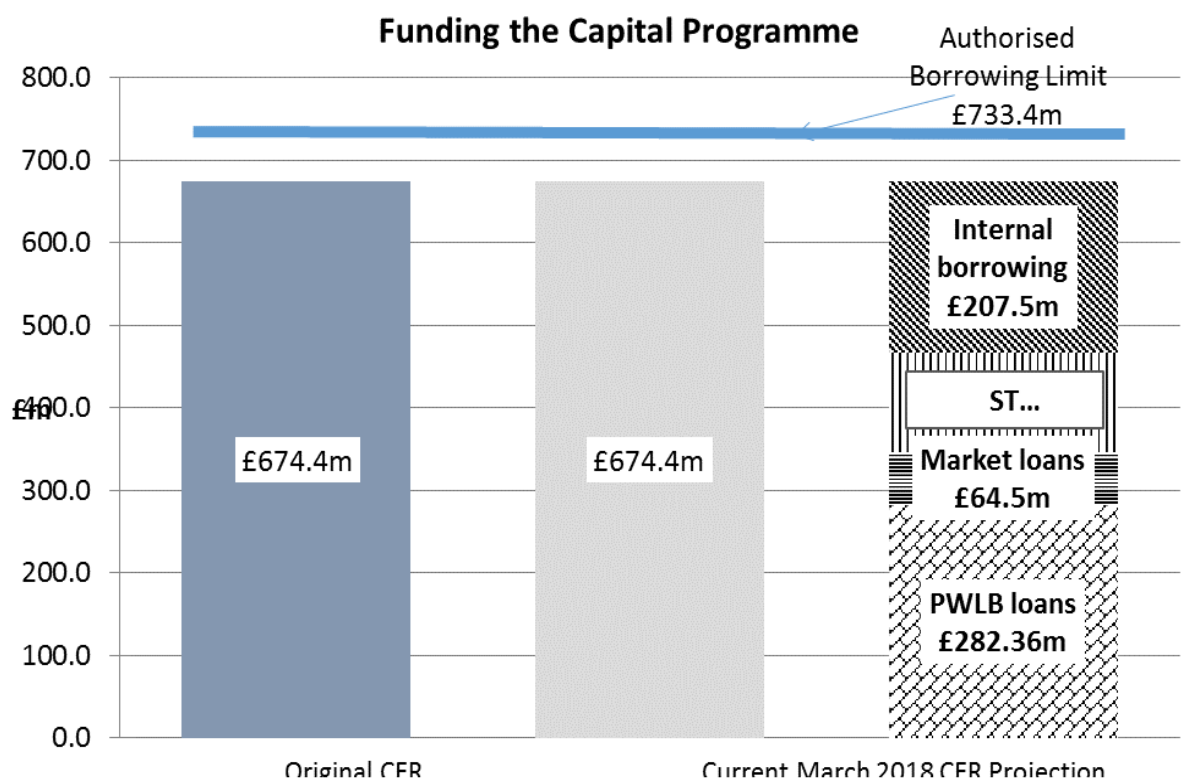


Loan restructuring:

- 5.5 When market conditions are favourable long term loans can be restructured to:
- to generate cash savings
 - to reduce the average interest rate
 - to enhance the balance of the portfolio by amending the maturity profile and/or the level of volatility. (volatility is determined by the fixed/variable interest rate mix)
- 5.6 During the quarter there were no opportunities for the Council to restructure its borrowing due to the position of the Council's borrowing portfolio compared to market conditions. Debt rescheduling will be considered subject to conditions being favourable but it is unlikely that opportunities will present themselves during this year. The position will be kept under review, and when opportunities for savings do arise, debt rescheduling will be undertaken to meet business needs.

Funding the Capital Programme:

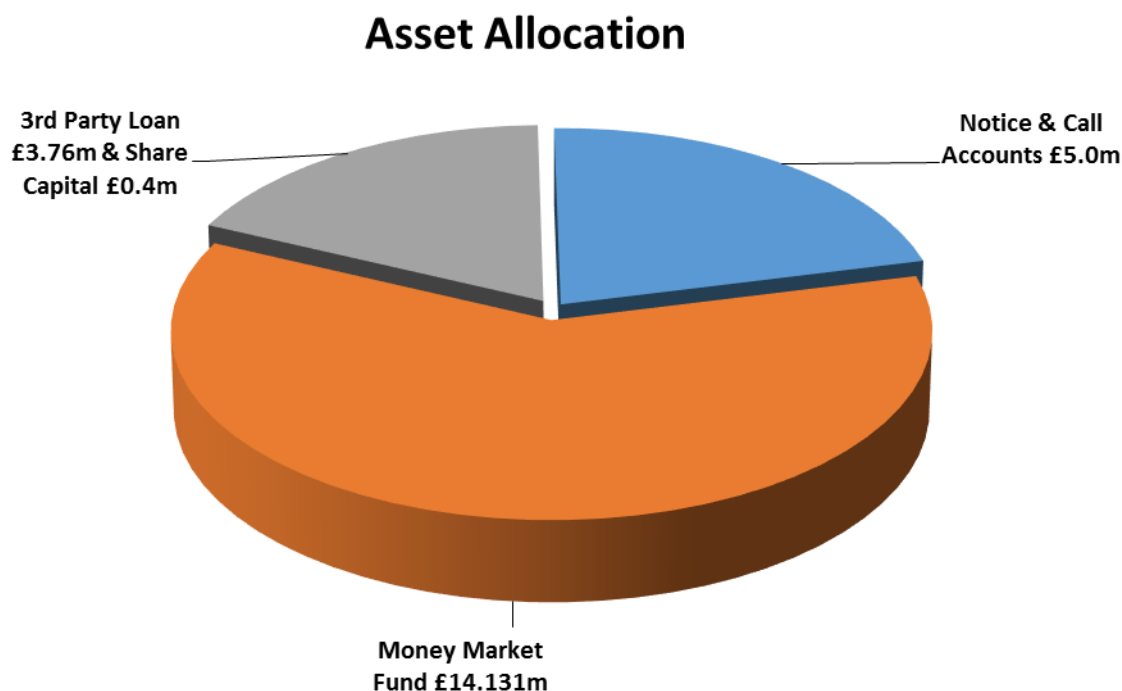
- 5.7 The Treasury Management Strategy Statement (TMSS) sets out the plan for treasury management activities over the next year. It identifies the expected level of borrowing and investment levels. When the 2017-18 TMSS was set, it was anticipated that the Capital Financing Requirement (CFR), the Council's liability for financing the agreed Capital Programme, would be £674.4m. This figure is naturally subject to change as a result of changes to the approved capital programme.
- 5.8 The Chart below compares the maximum the Council could borrow in 2017-18 with the forecast CFR at 31st March 2018 and the actual position of how this is being financed at 31st December 2017.



- 5.9 As shown on the chart above, it can be seen that the council's current CFR projection is £59.0m below the statutory Authorised Borrowing Limit set for the Council at the start of the year.
- 5.10 In addition, the chart shows how the Council is currently funding its borrowing requirement (through internal and external resources). As at 31st December 2017, based on current projections of the Capital Financing Requirement, internal borrowing is expected to be approximately £207.5m. Internal borrowing is the use of the Council's surplus cash to finance the borrowing liability instead of borrowing externally.

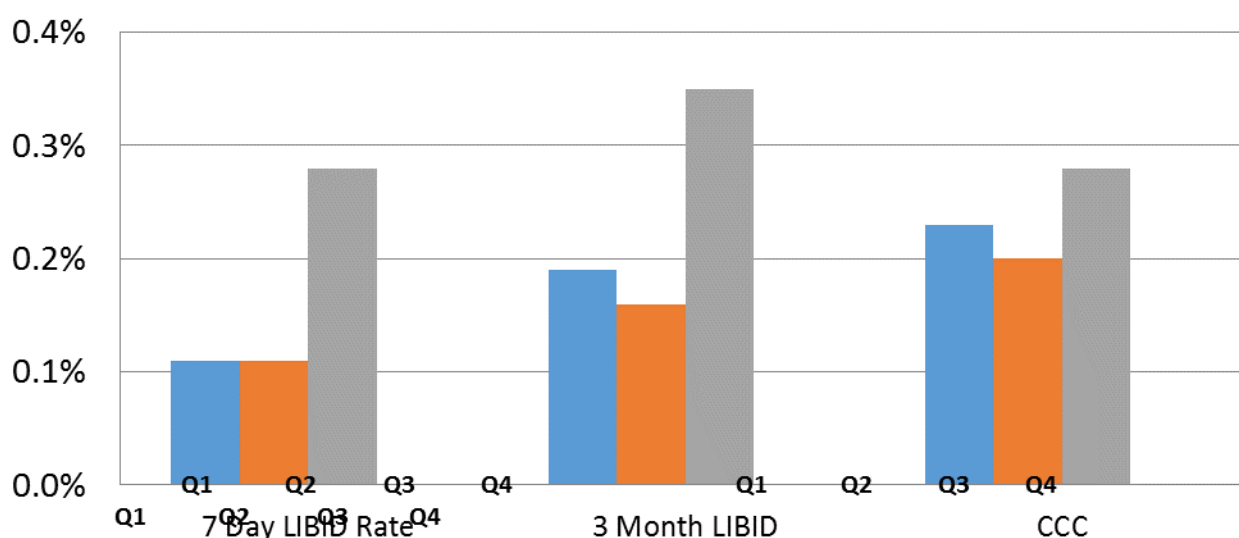
6. INVESTMENTS

- 6.1 Investment activity is carried out within the Council's counterparty policies and criteria, and with a clear strategy of risk management in line with the Council's treasury strategy for 2017-18. This ensures that the principle of considering security, liquidity and yield, in that order (SLY), is consistently applied. The Council will therefore aim to achieve the optimum return on investments commensurate with proper levels of security and liquidity. Any variations to agreed policies and practices are reported to GPC and Council.
- 6.2 As described in section 5, the strategy currently employed by the Council of internal borrowing also has the affect of limiting the Council's investment exposure to the financial markets, thereby reducing credit risk.
- 6.3 As at 31st December 2017 the level of investment totalled £19.13m, excluding 3rd party loans and share capital which are classed as capital expenditure. The level of cash available for investment is as a result of reserves, balances and working capital the Council holds. These funds can be invested in money market deposits, placed in funds or used to reduce external borrowings.
- 6.4 A breakdown of investments by asset allocation are shown in the graph below, with detail at **Appendix 3**. The majority of investments are in notice and call accounts and money market funds to meet the liquidity demands of the Council. The weighted average time to maturity of investments at 31st December is 1 day. Where possible deposits are placed for longer durations with appropriate counterparties to obtain enhanced rates of return.



- 6.5 The graph below compares the returns on investments with the relevant benchmarks for the each quarter this year.

Return on Investment Q3 2017-18



6.6 It can be seen from the graph that investments returned 0.28% during the 3rd quarter which is equivalent to the 7 day LIBID (0.28%) benchmark, but below the 3 month LIBID (0.35%) benchmark. The variance versus 3 month LIBID was as a result of the increase in base rate in November 2017. The greatest proportion of the Council's investment portfolio is placed in Money Market Funds which typically lag 1 to 2 months behind following a rate increase as existing investments in the fund mature and are replaced by new investments at current market levels.

6.7 Using credit ratings, the investment portfolio's historic risk of default stands at 0.0001%. This simply provides a calculation of the possibility of average default against the historical default rates. The Council is also a member of a benchmarking group run by LAS which shows that, for the value of risk undertaken and duration of investments, the returns generated are currently below the Model Band. This is because the Council maintains low cash balances compared to the size of its balance sheet, and a high proportion of these balances are held in a low interest bearing instant access account with Barclays, to meet business needs.

6.8 Leaving market conditions to one side, the Council's return on investment is influenced by a number of factors, the largest contributors being the duration of investments and the credit quality of the institution or instrument. Credit risk is a measure of the likelihood of default and is controlled through the creditworthiness policy approved by Council. The duration of an investment introduces liquidity risk; the risk that funds can't be accessed when required, and interest rate risk; the risk that arises from fluctuating market interest rates. These factors and associated risks are actively managed by the LGSS Treasury team together with the Council's Treasury Advisors (LAS).

7. OUTLOOK

7.1 The current interest rate forecast is shown in the table below. The performance of the economy over the coming months will be critical for any further monetary policy easing or tightening. The central forecast now is for a further increase in Bank Rate to commence in quarter ending December 2018, but this will very much depend on how

strongly and how soon the economy makes a gradual recovery, and so continue a process of very gradual increases in Bank Rate over a prolonged period.

- 7.2 Geopolitical events, sovereign debt crisis developments and slowing emerging market economies make forecasting PWLB rates highly unpredictable in the shorter term. The general expectation for an eventual trend of gently rising gilt yields and PWLB rates is expected to remain unchanged. An eventual world economic recovery may also see investors switching from the safe haven of bonds to equities.

Link Asset Services Interest Rate View													
	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%
5yr PWLB rate	1.60%	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%
10yr PWLB rate	2.20%	2.30%	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%
25yr PWLB rate	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB rate	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%

- 7.3 From a strategic perspective, the Council is continually reviewing options as to the timing of any potential borrowing and also the alternative approaches around further utilising cash balances and undertaking shorter term borrowing which could potentially generate savings subject to an assessment of the interest rate risks involved. Cash flows in the last couple of years have been sufficiently robust for the Council to use its balance sheet strength to limit the amount of new long term borrowing undertaken.

8. THIRD PARTY LOANS

- 8.1 A loan to Arthur Rank Hospice Charity of £4m was approved in 2015-16 and advanced in the form of a secured loan in June 2016 to enable the charity to build a 24 bedded hospice.
- 8.2 Interest and principal repayments for this loan have been made accordance with the loan agreements.

9. DEBT FINANCING BUDGET

- 9.1 Overall a £2,006k underspend is currently forecasted and reported for Debt Charges. The forecast has been updated following work on technical adjustments on capitalisation of interest and the finalisation of 2017-18 MRP calculation by officers during quarter 2. Further analysis on the capitalisation of interest will take prior to year-end subject to the application of alternate funding streams (S106 agreements, grants, etc.) that had not been forecast in the original estimate.
- 9.2 Although there is a link between the capital programme, net borrowing and the revenue budget, the Debt Charges budget is impacted by the timing of long term borrowing decisions. These decisions are made in the context of other factors including, interest rate forecasts, forecast levels of cash reserves and the borrowing requirement for the Council over the life of the Business Plan and beyond.

10. MUNICIPAL BONDS AGENCY

- 10.1 This authority approved entry into the Framework Agreement, which allows the Council to borrow through the Municipal Bonds Agency (MBA) at lower rates than from the Public Works Loan Board. It is not anticipated that any borrowing will be raised in this way during the course of the year. Currently four councils (including Westminster Council & Cambridgeshire County Council) have been approved for the first tranche of the bonds issuance. It is anticipated that the sign off and dating of the Joint and Several Framework Agreement by the first four councils during quarter 4 2017/18 with bond issuance to happen shortly thereafter.

11. COMPLIANCE WITH TREASURY LIMITS AND PRUDENTIAL INDICATORS

- 11.1 With effect from 1st April 2004 The Prudential Code became statute as part of the Local Government Act 2003 and was revised in 2011.
- 11.2 The key objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of the Council are **affordable, prudent and sustainable**. To ensure compliance with this the Council is required to set and monitor a number of Prudential Indicators.
- 11.3 During the financial year to date the Council has operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Management Strategy Statement (TMSS) and in compliance with the Council's Treasury Management Practices. The Prudential and Treasury Indicators are shown in **Appendix 1**.

12. ALIGNMENT WITH CORPORATE PRIORITIES

12.1 Developing the local economy for the benefit of all

There are no significant implications for this priority.

12.2 Helping people live healthy and independent lives

There are no significant implications for this priority.

12.3 Supporting and protecting vulnerable people

There are no significant implications for this priority.

13. SIGNIFICANT IMPLICATIONS

13.1 Resource Implications

This report provides information on performance against the Treasury Management Strategy. Section 10 shows the impact of treasury decisions impacting the Debt Charges Budget, which are driven by the capital programme and the Council's overall financial position.

13.2 Procurement/Contractual/Council Contract Procedure Rules Implications

There are no significant implications within this category.

13.3 Statutory, Legal and Risk Implications

The Council continues to operate within the statutory requirements for borrowing and investments. Further details can be found within the Prudential Indicators in **Appendix 1**.

13.4 Equality and Diversity Implications

There are no significant implications in this category.

13.5 Engagement and Communication Implications

There are no significant implications in this category.

13.6 Localism and Local Member Involvement

There are no significant implications in this category

13.7 Public Health Implications

There are no significant implications in this category

Implications	Officer Clearance
Have the resource implications been cleared by Finance?	Yes Name of Financial Officer: Chris Malyon
Has the impact on Statutory, Legal and Risk implications been cleared by LGSS Law?	No Name of Legal Officer: Fiona McMillan n/a
Are there any Equality and Diversity implications?	No Name of Officer: n/a
Have any engagement and communication implications been cleared by Communications?	No Name of Officer: n/a
Are there any Localism and Local Member involvement issues?	No Name of Officer: n/a
Have any Public Health implications been cleared by Public Health	No Name of Officer: n/a

Source Documents	Location
None	Not applicable

Prudential and Treasury Indicators at 31st December 2017

Monitoring of Prudential and Treasury Indicators: approved by Council in February 2017.

1. **Has the Council adopted CIPFA Code of Practice for Treasury Management in the Public Services?**

The Council has adopted CIPFA's Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes. This is a key element of the Treasury Strategy 2017-18 which was approved by Council in February 2017.

2. **Limits for exposure to fixed and variable rate net borrowing (Borrowing less investments)**

	Limits	Actual
Fixed rate	150%	73.12%
Variable rate	65%	26.88%
Total		100%

The Interest rate exposure is calculated as a percentage of net debt. Due to the mathematical calculation exposures could be greater than 100% or negative depending upon the component parts of the formula. The formula is shown below:

$$\frac{\text{Total Fixed (or Variable) rate exposure}}{\text{Total borrowing} - \text{total investments}}$$

Fixed Rate calculation:

$$\frac{(\text{Fixed rate borrowing } £327.4m^* - \text{Fixed rate investments } £0m^*)}{\text{Total borrowing } £466.9m - \text{Total investments } £19.1m} = 73.12\%$$

*Defined as greater than 1 year to run

Variable Rate calculation:

$$\frac{(\text{Variable rate borrowing } £139.5m^{**} - \text{Variable rate investments } £19.1m^{**})}{\text{Total borrowing } £466.9m - \text{Total investments } £19.1m} = 26.88\%$$

** Defined as less than 1 year to run or in the case of LOBO borrowing the call date falling within the next 12 months.

3. **Total principal sums invested for periods longer than 364 days**

	2017-18 Limit £m	Actual £m
Investment longer than 364 days to run	0.0	0.0

Notes: This indicator is calculated by adding together all investments that have greater than 364 days to run to maturity at the reporting date.

4. **Limits for maturity structure of borrowing**

	Upper Limit	Actual
under 12 months	80%	30%
12 months and within 24 months	50%	2%
24 months and within 5 years	50%	10%
5 years and within 10 years	50%	15%
10 years and above	100%	43%

Note: The guidance for this indicator requires that LOBO loans are shown as maturing at the next possible call date rather than at final maturity.

Affordability

5. **Ratio of financing costs to net revenue stream**

2017-18 Original Estimate %	2017-18 Revised Estimate %	Difference %
7.7	6.32	-1.38

6. **Estimated incremental impact of capital investment decisions on band D council tax**

2017-18 Original Estimate £	2017-18 Revised Estimate £	Difference £
11.38	11.75	0.37

Prudence:

7. Gross borrowing and the Capital Financing Requirement (estimated borrowing liability excluding PFI)

Original 2017-18 Capital Financing Requirement (CFR) £m	2017-18 CFR (based on latest capital information) £m	Actual Gross Borrowing £m	Difference between actual borrowing and original CFR £m	Difference between actual borrowing and latest CFR £m
674.4	674.4	466.8	207.6	207.6

Capital Expenditure

8. Estimates of capital expenditure

For details of capital expenditure and funding please refer to the monthly capital report.

External Debt

9. Authorised limit for external debt

2017-18 Authorised Limit £m	Actual Borrowing £m	Headroom £m
733.4	466.8	266.6

The Authorised limit is the statutory limit on the Council's level of debt and must not be breached. This is the absolute maximum amount of debt the Council may have in the year.

10. Operational boundary for external debt

2017-18 Operational Boundary £m	Actual Borrowing £m	Headroom £m
703.4	466.8	236.6

The operational boundary is set as a warning signal that debt has reached a level nearing the Authorised limit and must be monitored carefully.

Appendix 2

Investment Portfolio as at 31st December 2017

Class	Type	Deal Ref	Start / Purchase Date	Maturity Date	Counterparty	Profile	Rate	Principal O/S (£)
Deposit	Fixed	CCC/88	16/06/16	16/06/41	Arthur Rank Hospice Charity	EIP	3.3400%	-3,760,000.00
Fixed Total							3.3400%	-3,920,000.00
Deposit	Call	CCC/CE/6	01/12/14	01/01/2018	Barclays Bank plc	Maturity	0.4000%	-5,000,000.00
Call Total							0.4000%	-5,000,000.00
Deposit	Variable	CCC/59	25/09/14	25/09/24	The UK Municipal Bonds Agency	Maturity	0.0000%	-400,000.00
Variable Total							0.0000%	-400,000.00
Deposit	MMF	CCC/ST/3	31/03/14	01/01/2018	SLI Sterling Liquidity/CI 2	Maturity	0.3491%	-966,000.00
Deposit	MMF	CCC/ST/7	22/07/15	01/01/2018	Deutsche Managed Sterling Platinum	Maturity	0.2936%	-13,165,000.00
MMF Total							0.2974%	-14,131,000.00
Deposit Total							0.8055%	-23,291,000.00
Grand Total								-23,291,000.00