TREASURY MANAGEMENT STEWARDSHIP ANNUAL REPORT 2017/18

Report of the County Treasurer

Please note that the following recommendations are subject to consideration and determination by the Committee before taking effect.

Recommendation: that the Committee notes the report and considers whether it wishes to make any further comments to Cabinet.

1. Introduction

1.1. The County Council has adopted the CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management in the Public Services. A revised Code of Practice was published by CIPFA in November 2011 and a revised Policy Statement and Treasury Management Practices (TMPs) were agreed by Council in February 2016. The Treasury Management and Investment Strategy for 2017/18 was agreed by Council in February 2017 and forms part of the published budget book.

1.2. The purpose of this report is to show the outturn position, review performance and inform members of any key matters arising from the Council's Treasury and Debt Management activities during the 2017/18 financial year. The report also includes an update on the 2018/19 Strategy. This report, together with any comments offered by this committee, will be considered by Cabinet on 11th July.

2. Minimum Revenue Provision

2.1. Each year the Council has a statutory obligation to charge to the revenue account an annual amount of Minimum Revenue Provision (MRP), which is a charge to make provision for the repayment of the authority's external debt and internal borrowing. The charge is based on the historic borrowing required to fund the Council's capital programme.

2.2. In February, the County Council changed the Minimum Revenue Provision Policy for 2017/18 to allow for £10.916 million of overprovision in earlier years to be placed into an Earmarked Reserve to offset the risk of increased costs in future years due to changes being proposed in a Central Government Consultation. The results of the Consultation are now known and the proposed change that would have seen an annual increased cost of c.£2 million to the authority has not been made; the future use of the Earmarked Reserve will be considered in 2018/19.

3. Treasury Management Outturn Position 2017/18 - Borrowing

3.1. The overall aims of the borrowing strategy are to achieve:

- Borrowing at the lowest rates possible in the most appropriate periods;
- The minimum borrowing costs and expenses;
- A reduction in the average interest rate of the debt portfolio.

3.2. Since 2009 the Council has followed a policy of containing the capital programme, taking out no new external borrowing and repaying debt whenever this can be done without incurring a financial penalty. Therefore, the Medium Term Financial Strategy (MTFS) assumption was that no new long-term borrowing would be required.

3.3. In accordance with the MTFS, no long-term borrowing was undertaken during the 2017/18 financial year. Instead all borrowing required to fund capital expenditure was met from internal cash balances.

3.4. Active treasury management and the maintenance of levels of liquidity have ensured that no short-term borrowing required was required during the financial year. Cash positions are monitored daily and modelled over a monthly horizon to ensure that anticipated liquidity levels are forecast accurately.

3.5. No opportunities arose during the 2017/18 financial year to repay outstanding debt without incurring substantial premium penalties, which would negate any benefit of repaying the debt. The Public Works Loan Board (PWLB) sets premature repayment rates, and where the interest rate payable on a current loan is higher than the repayment rate, the PWLB policy imposes premium penalties for early repayment. With current low rates of interest these penalties would be of a significant cost. Therefore it will only make financial sense to repay debt early if the PWLB changes its current policy, or if interest rates rise and cancel out the repayment premiums.

3.6. At 31st March 2018 the level of long term debt stood at £507.85m as detailed in the table below.

Analysis of Long Term Debt

	Actual 31.03.17 £'m	Interest Rate %	Current 31.03.18 £'m	Interest Rate %
Fixed Rate Debt				
PWLB	436.35	4.99	436.35	4.99
Money Market	71.50	5.83	71.50	5.83
Variable Debt				
PWLB	0.00		0.00	
Money Market	0.00		0.00	
Total External Borrowing	**507.85**	**5.11**	**507.85**	**5.11**

3.7. The carrying amount for long term debt figure presented in the Statement of Accounts for 2017/18, comprising PWLB, LOBO and market debt, is £522.441m, £14.6m greater than the figure stated above. This difference is due to an accounting standard adjustment which requires us to record the value of our long term debt at its Net Present Value in the Statement of Accounts. The LOBOs (Lender Option Borrower Option) have stepped interest rates and are revalued annually based on the effective interest rate for the duration of the loan. There was £10.9m of PWLB interest outstanding at year end which is also taken into account. The revaluation has the effect of smoothing the stepping of the interest over the life of the loans.

4. Treasury Management Outturn Position 2017/18 - Investments

4.1. The overall aim of the Council's investment strategy is to:

- Limit the risk to the loss of capital;
- Ensure that funds are always available to meet cash flow requirements;

- Maximise investment returns, consistent with the first two aims;
- Review new investment instruments as they come to the Local Authority market, and to assess whether they could be a useful part of our investment process.

4.2. Following the outcome of the EU referendum in June 2016, the Bank of England was concerned about the impact of the result on the wider economy. They therefore decided to reduce the base rate from 0.5% to 0.25%. As a result of this and other global concerns that impacted on banks, the rates available for bank deposits fell, and as a result the target rate for bank and building society deposits in 2017/18 was lowered to 0.4%. Subsequently the Bank of England base rate was increased back up to 0.5% in November 2017.

4.3. Following the November rise in the base rate, the interest rates on offer to the Council increased, but there was only a limited scope to take advantage of the increased rates during the remainder of the financial year. The average interest rate earned on investments, excluding the CCLA property fund, for the year was 0.54%, against the full year budget target return of 0.40%. The CCLA property fund has yielded an average rate of 4.36% for the same period against a full year budget target of 4.5%. The combined total return from all investments was 0.74%.

4.4. Revenue lending during 2017/18, including the use of term deposits, call accounts and property funds, earned interest of £1.35 million against a full year budget of £750,000. The surplus achieved over budget can be partly attributed to the higher rates of interest earned compared to the target rate. The Council also had more cash to invest than forecast, as a result of slippage on the capital programme and additions to reserves during the year. The interest figure quoted is the return from the Council’s Treasury Management activity and is different from the figure presented in the Outturn Report and the Statement of Accounts which also includes interest generated from a number of other sources.

4.5. All lending has been carried out in accordance with the Council's Treasury Management Strategy and with institutions on the list of approved counterparties.

4.6. The following table shows the County Council's fixed and variable rate investments as at the start and close of the financial year:

Schedule of Investments

	Maturing in:	Actual 31.03.17 £'m	Interest Rate %	Current 31.03.18 £'m	Interest Rate %
Bank and Building Society Deposits					
Fixed Rates					
Term Deposits	< 365 days	66.50	0.66	117.50	0.73
	365 days & >	0.00		0.00	
Callable Deposits					
Variable Rate					
Notice Accounts		30.00	0.75	5.00	1.05
Call Accounts		0.00		27.02	0.40
Money Market Funds (MMFs)		20.74	0.29	30.00	0.46
Property Fund		10.00	4.45	10.00	4.42
All Investments		**127.24**	**0.92**	**189.52**	**0.84**

4.7. The figure as at 31st March 2018 includes approximately £12.8m related to the Growing Places Fund (GPF). This figure was approximately £14.3m as at 31st March 2017. Devon County Council is the local accountable body for the GPF, which was established by the Department for Communities and Local Government to enable the development of local funds to address infrastructure constraints, promoting economic growth and the delivery of jobs and houses. The Council is working in partnership with the Local Economic Partnership, and interest achieved on the GPF funds, based on the average rate achieved by the Council’s investments, will accrue to the GPF and not to the County Council.

5. Prudential Indicators

5.1. Linked to its Treasury Management Strategy, the County Council is required to monitor its overall level of debt in line with the CIPFA Code of Practice. Part of the code requires consideration of a set of Prudential Indicators in order to allow the Council to form a judgement about the affordable, prudent and sustainable level of debt.

5.2. The purpose of the indicators is to demonstrate that:

- Capital expenditure plans are affordable;
- All external borrowing and other long term liabilities are within prudent and sustainable levels;
- Treasury management decisions are taken in accordance with professional good practice.

5.3. Three Prudential Indicators control the overall level of borrowing. They are:

- **The authorised limit** - this represents the limit beyond which any additional borrowing is prohibited until the limit is revised by the County Council. Revision may occur during the year if there are substantial and unforeseen changes in circumstances, for example, a significant delay in achieving forecast capital receipts. In normal circumstances this limit will not require revision until the estimate for the following year is revised as part of the budget setting process.
- **The operational boundary** – this indicator is based on the probable external debt and other long term liabilities during the year. Variations in cash flow may lead to occasional, short term breaches of the Operational Boundary that are acceptable.
- **The upper limit for net debt** - the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the Capital Financing Requirement.

5.4. During the Budget process, the following Borrowing Limits were set for 2017/18:

- Maximum borrowing during the period (Authorised Limit) £881.93m.
- Expected maximum borrowing during the year (Operational Limit) £856.93m.
- Underlying Borrowing Requirement to Gross Debt - £160.5m under borrowing.
- Maximum amount of fixed interest exposure (as a percentage of total) 100%.
- Maximum amount of variable interest exposure (as a percentage of total) 30%.

5.5. Members are asked to note that during 2017/18 the Council remained within its set Borrowing Limits and complied with the interest rate exposure limits.

6. 2018/19 Update

6.1. The Medium Term Financial Strategy assumes that, over the three year period, no new long-term borrowing will be required. This is still envisaged to be the case, although this will be kept under review.

6.2. The PWLB policy of imposing premium penalties for the early repayment of long term debt means there is little potential to repay further debt during the current financial year.

6.3. Forecasting future interest rates is difficult as the factors affecting interest rate movements are outside of the Council’s control. Whilst short term rates are generally linked to the Bank of England’s Base Rate, long term rates are determined by other factors, e.g. the market in Gilts. The County Council retains an external advisor, Link Asset Services (formerly

Capita), who forecast future rates several years forward. Similar information is received from a number of other sources.

6.4. For 2018/19, the Council set a prudent target rate for lending to bank and building society deposits of 0.55%, with a target rate for the investment in the CCLA Property Fund of 4.5%. The 0.55% target rate took into account the November 2017 increase in the Bank of England base rate, which has resulted in increased rates being available compared to those available before the increase. However, it made no allowance for any further increases. This strategy has proved correct, as a much heralded increase in rates in May 2018 failed to materialise, with the Bank of England expressing concern around the downturn in economic data since mid-February.

6.5. Link Asset Services are now forecasting an increase in the base rate up to 0.75% in November, but this is not guaranteed, and there will be limited opportunities for the Council to take advantage of any increase before the end of the 2018/19 financial year. It is anticipated that the budgeted income target of £1 million will be achieved.

7. Summary

7.1. No long term or short-term borrowing was undertaken during 2017/18. It is not envisaged that any new long-term borrowing will be required over the next three year period but this will be reviewed annually.

7.2. No opportunities arose during the 2017/18 financial year to repay outstanding debt without incurring substantial premium penalties, which would negate the benefit of repaying the debt.

7.3. Investment income of £1.35 million was achieved in 2017/18 against a full year budget of £750,000. This represented a return of 0.74%, including the Property Fund investment. Successful prudent management of the Council's short-term cash reserves has delivered a surplus of £600,000 for the 2017/18 financial year.

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Electoral Divisions: All
Local Government Act 1972
List of Background Papers - Nil
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