CT/17/103
Corporate Infrastructure & Regulatory Services Scrutiny Committee
28 November 2017

Treasury Management - Mid Year Stewardship Report 2017/18

Report of the County Treasurer

All recommendations contained in this report are subject to confirmation by the Committee before taking effect.

Recommendation: That the Committee consider whether it wishes to draw to the attention of the Cabinet any observations on the Treasury Management Mid Year Stewardship Report.

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 2017. 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 inform members of any key matters arising from the Council's Treasury and Debt Management activities during the first seven months of the 2017/18 financial year. It is intended to enable members to ensure that agreed policy is being implemented. This report, together with any comments offered by this committee, will be considered by Cabinet on 13th December.

2. Borrowing Strategy for 2017/18 – 2019/20

2.1. The overall aims of the Council's 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.

2.2. The Medium Term Financial Strategy assumes that, over the three year period, no new long-term borrowing will be required, although this will be kept under review. The majority of the capital programme is funded by capital grants or use of capital receipts. Some use is made of internal borrowing from the Council's cash resources, and prudent management of the capital programme aims to ensure that there is no requirement to take on additional external borrowing.

2.3. If short-term borrowing is required to aid cashflow, this will be targeted at an average rate of 0.4%.

3. Implementation of the borrowing strategy in 2017/18

3.1. Active treasury management and the maintenance of levels of liquidity have ensured that no short term borrowing required has been required for the financial year to date. Cash positions are monitored daily and modelled over a monthly horizon to ensure that anticipated liquidity levels are forecast accurately.

3.2. In accordance with the Medium Term Financial Strategy no long term external borrowing has been undertaken this financial year. Instead all borrowing required to fund capital expenditure has been funded by internal cash balances. This position will be kept under review, but the expectation remains that no new external borrowing will be required during the three year period.

3.3. At 31st October 2017 the level of long term debt is £507.85m as detailed in the table below.

Analysis of Long Term Debt

	Actual 31.03.17 £'m	Interest Rate %	Actual 31.10.17 £'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**

3.4. It should be noted that the long term debt figure presented in the Statement of Accounts will be different 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 Money Market loans, or 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. This revaluation has the effect of smoothing the stepping of the interest over the life of the loans.

3.5. The majority of the Council's borrowing is from the Public Works Loan Board (PWLB); however, there are three outstanding LOBO loans, totalling £46.5 million and one fixed loan valued at £25m (previously a LOBO), as shown in the above table. These are historic loans which were all taken out over thirteen years ago, at an initial lower rate of interest that then stepped up to a higher rate after the initial period. There is no further stepping built into any of the loans, but the lenders of the LOBOs have the option to increase the interest rate at each half year date. If the lender exercises this option, the Council would then have the option of repaying the loan in full, incurring no early repayment premium, or to continue making repayments at the higher rate of interest. Given the current level of interest rates it is unlikely that this will happen for many years.

3.6. No opportunities have arisen during this financial year to repay outstanding debt without incurring substantial premium penalties, which would negate any benefit of repaying the debt. The 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.

4. Investment Strategy in 2017/18

4.1. The investment performance of the County Council's cash continues to be affected by the low interest rates currently available, and the returns on the County Council's cash investments are forecast to remain at low levels for the foreseeable future. The Treasury Management Strategy will continue to ensure a prudent and secure approach.

4.2. 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.

5. Implementation of the investment strategy in 2017/18

5.1. The following table shows the County Council's fixed and variable rate investments as at the start of the financial year and as at 31st October 2017:

Schedule of Investments

	Maturing in:	Actual 31.03.17 £'m	Interest Rate %	Actual 31.10.17 £'m	Interest Rate %
Bank, Building Society & MMF Deposits					
Fixed Rates					
Term Deposits	< 365 days	66.50	0.66	62.50	0.56
	365 days & >	0.00		0.00	
Callable Deposits					
Variable Rate					
Call & Notice Accounts		30.00	0.75	90.00	0.44
Money Market Funds (MMF's)		20.74	0.29	38.97	0.30
Property Fund		10.00	4.45	10.00	4.27
All Investments		**127.24**	**0.92**	**201.47**	**0.64**

5.2. The figure as at 31st March 2017 includes approximately £14.3m related to the Growing Places Fund (GPF). This figure was approximately £13.4m as at 31st October 2017. Devon County Council has agreed to be the local accountable body for the GPF, which has been 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.

5.3. The value of the Council's investments as at 31st October reflect the fact that cash balances tend to increase during the first half of the year as Government grants and other income are received, before tapering back down again during the latter part of the financial year.

5.4. Following the outcome of the EU referendum in June 2016, the Bank of England reduced the base rate from 0.5% to 0.25%, following concerns about the impact of the result on the wider economy. As a result of this and other global concerns that have impacted on banks, rates have continued to fall. This has had an impact on the investment returns that we have been able to achieve. The average interest rate earned on investments, excluding the CCLA property fund, for the 7 months to 31st October 2017 was 0.53%, against a full year budget target return of 0.40%. Following the Bank of England's decision at the beginning of November to return the base rate back up to 0.5%, there are signs that rates are beginning to increase marginally. The CCLA property fund has yielded an average rate of 4.30% for the same period against a full year budget target of 4.50%. The combined total return from all investments was 0.73%.

5.5. Revenue lending during the current year to date, including the use of term deposits, call accounts, money market funds and the CCLA property fund, has earned interest of £769,000 against a full year budget of £750,000. The budget for investment income will be achieved for the full financial year. The surplus income has resulted from cash balances during the year to date being higher than anticipated, plus a higher average rate being achieved than budgeted for.

5.6. The County Council continues to adopt a very prudent approach to counterparties to whom the County Council is willing to lend. As a result only a small number of selected UK banks, building societies and money market funds and Non-Eurozone overseas banks in highly rated countries have been used, subject to strict criteria and the prudent management of deposits with them. A longer-term investment of £10m has also been made in the CCLA (Churches, Charities and Local Authorities) Property Fund.

5.7. The lending policy is kept under constant review with reference to strict criteria for inclusion in the counterparty list. All lending has been carried out in accordance with the Council's Treasury Management Strategy and with institutions on the list of approved counterparties. There have been no breaches of credit limits.

6. Minimum Revenue Provision (MRP)

6.1. 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.

6.2. The current policy, following a review in 2015/16 is to charge MRP in equal instalments over the life of the asset benefiting from the capital spend. The budgeted MRP for 2017/18 is £18.4m.

7. Prudential Indicators

7.1. 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.

7.2. 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.

7.3. 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 2018/19 is revised as part of the 2018/19 budget 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 Underlying Borrowing Requirement to Gross Debt** - the Council also needs to ensure that its gross debt does not, except in the short term, exceed the total of the Capital Financing Requirement.

7.4. 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 Boundary)** - £856.93m

- Maximum amount of fixed interest exposure (as a percentage of total) - 100%

- Maximum amount of variable interest exposure (as a percentage of total) - 30%

7.5. Members are asked to note that for 2017/18 to date, the Council has remained within its set Borrowing Limits and has complied with the interest rate exposure limits.

8. Prospects for 2018/19

8.1. Economic forecasting remains difficult with so many external influences weighing on the UK. Bank rate forecasts will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Forecasts for average earnings beyond the three year time horizon will be heavily dependent on economic and political developments. Volatility in bond yields is likely to endure as investor fears and confidence ebb and flow between favouring relatively more “risky” assets i.e. equities, or the “safe haven” of government bonds.

8.2. At the beginning of November the Bank of England Monetary Policy Committee decided to remove the post EU referendum emergency monetary stimulus implemented in August 2016 and restore the Base Rate to 0.5%. At the same time they 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.

8.3. The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. A world economic recovery will likely see investors switching from the safe haven of bonds to equities. However, the outlook remains extremely uncertain. Risks to the downside include:

- Continuing uncertainty as a result of Brexit.

- Geopolitical risks, especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

- A resurgence of the Eurozone sovereign debt crisis, possibly Italy, due to its high level of government debt, low rate of economic growth and vulnerable banking system.

- Weak capitalisation of some European banks.

- Rising protectionism under President Trump

- A sharp Chinese downturn and its impact on emerging market countries

8.4. In view of this, it is likely that the target investment return for 2018/19 for bank, building society and money market deposits will be set at a slightly higher level than the 0.40% target for 2017/18, but will depend on whether we see any further moves in interest rates over the next month or so following the increase in the Bank of England Base Rate. We expect to achieve a higher rate of return in the region of 4.0% to 4.5% for the CCLA property fund.

9. Summary

9.1. No long term borrowing has been undertaken to date in 2017/18. The expectation is that no new borrowing will be required during the remainder of the 2017/18 financial Year.

9.2. No short term borrowing has been undertaken to date in 2017/18. The expectation is that no new borrowing will be required during the remainder of the 2017/18 financial Year.

9.3. Investment income is forecast to over-achieve against the budget target of £750,000 in 2017/18.

Mary Davis

Electoral Divisions: All
<u>Local Government Act 1972</u>
<u>List of Background Papers – Nil</u>
Contact for Enquiries: Mark Gayler / Dan Harris
Tel No: (01392) 383621 Room G97 / G99