Rother District Council **Agenda Item: 5.2**

Report to	-	Audit and Standards Committee
Date	-	24 September 2018
Report of the	-	Executive Director
Subject	-	Treasury Management Report – Mid Year Review

Recommendation: It be **RESOLVED**: That the report be noted.

Assistant Director: Robin Vennard
Financial Services Manager: Catherine Jobling

Introduction

1. Cabinet approved the Council's 2018/19 Investment Strategy in February this year. The investment strategy requires regular reports to be presented to this Committee on the Council's treasury management activities. Members are also reminded that investment activity is also reported through the Members' Bulletin. In managing its treasury management activities, the Council follows the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017).

2. Treasury Management covers two main areas:-

   i. The management of day to day cash flows by way of short term investing and borrowing. Longer term investment opportunities may arise depending on cashflow requirements.
   ii. Management of the Council's long term debt portfolio which is used to finance capital expenditure that cannot be immediately funded by internal resources (e.g.by Capital Receipts).

Economic Update

3. Appendix 1 is our treasury advisors, Link Asset Services' view on the current economic environment and their outlook for the remainder of 2018/19. It details the impact this is likely to have on the Council's investment performance.

Treasury Management Strategy and Annual Investment Strategy review

4. The Council currently makes most of its day to day treasury investments through the use of call and deposit accounts with the major financial UK institutions.

5. In addition to this, the Council has invested £5 million in the Churches, Charities, Local Authorities' (CCLA) Property Investment Fund. A further £3 million was invested in July 2018 into the HERMES Property Investment Fund.

6. The following paragraphs describe the recent investment activity and the level of investment returns currently being generated.

Investment Portfolio 2018/19

7. In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity and to obtain an appropriate level of return which is consistent with the Council's risk appetite. As set out in Appendix 1, it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades, as rates are very low with the Bank rate now at 0.75%. The Council's cash levels and cash flow profiles, as well as restrictions on maximum deposit duration, contribute to a low risk and short-term strategy. Given this risk averse environment, investment returns are likely to remain low.

8. The Council held £31m of investments as at 30 July 2018 and the investment portfolio yield to 31 July 2018 is £107,106 The average rate of return is 1.30%

The following table shows the current investments:

Deposit with	Type of account	Maturity Date	Amount	Interest rate
Nat West	Deposit	09/08/2018	£1,000,000	0.42
Nat West	Deposit	10/05/2019	£2,000,000	0.75
Lloyds	Deposit	21/12/2018	£2,000,000	0.75
Lloyds	Deposit	02/07/2019	£1,500,000	1
Lloyds	Deposit	05/07/2019	£1,000,000	1
Barclays	Deposit	31/10/2018	£2,000,000	0.7
Santander	31 Day Notice		£1,640	0.4
Barclays	Call Account		£1,061	0.05
Bank of Scotland	32 Day Notice		£2,300,000	0.57
Bank of Scotland	Call Account		£66	0.4
Lloyds - general	Call Account		£11,469,344	0.4
HERMES Property Fund	Long Term		£2,999,998	4.86 Est*
Local Authority Property Fund	Long Term		£5,000,000	4.47
TOTAL			**£31,272,109**	

* average over the last 9 years

9. The Assistant Director Resources (the Council's Chief Financial Officer) confirms that the approved limits within the Annual Investment Strategy were not breached during the first few months of 2018/19.

10. If the Hermes Property fund achieves the estimated return highlighted above, together with the other Council investments, the return for 2018/19 should be in

the region of £397,000. This is higher than reported to Cabinet earlier this month which was based on performance for the first quarter.

Investment Counterparty Criteria

11. The current investment counterparty criteria selection approved in the Treasury Management Strategy Statement is meeting the requirement of the treasury management function.

Capital Programme

12. A major part of the Council's Treasury Management Strategy concerns the Capital Programme, how it is funded and the impact this has on our taxpayers.

Financing of the Capital Programme

13. The table below draws together the main strategy elements of the capital expenditure plans, highlighting the original supported and unsupported elements of the capital programme and the expected financing arrangements of this capital expenditure. Any borrowing element of the table increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). Any direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

Rother District Council
Capital Programme Summary

	2018/19 Budget £ (000)	2019/20 Budget £ (000)	2020/21 Budget £ (000)
Total	10,552	10,585	20,130
Funded By:			
Capital Receipts	3,057	0	0
Grants and contributions	797	400	0
Capital Expenditure Charged to Revenue	2,360	185	130
Borrowing	4,338	10,000	20,000
Total Funding	10,552	10,585	20,130

Capital Financing Requirement and Borrowing

14. The Council's CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the Public Works Loan Board (PWLB) or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The CFR will increase each year by the amount of capital expenditure yet to be financed and is reduced by the amount that the Council sets aside for the repayment of borrowing.

15. £1.091 million of the CFR balance of £5.937 million represents an "Item A" adjustment dating back to 2004: this is the agreed historic amount on which it is

not necessary to provide the annual Minimum Revenue Provision (MRP) for repayment of debt. MRP would be payable for any capital expenditure financed from loan in the future.

16. It is expected that the Council's CFR projections will remain broadly the same as previous estimates for the foreseeable future as shown in the table below:

£m	**2018/19 Estimate £'000**	**2019/20 Estimate £'000**	**2020/21 Estimate £'000**
Capital Financing Requirement			
Total CFR	5,937	15,937	35,816
Movement in CFR	4,845	9,879	19,129

Movement in CFR represented by			
Net financing need for the year (above)	4,845	10,000	20,000
Less MRP/VRP and other financing movements	0	121	871
Movement in CFR	4,845	9,879	19,129

Limits to Borrowing Activity

17. To ensure the Council acts reasonably when entering into borrowing, the first key control over the treasury activity is a Prudential Indicator (PI) to ensure that over the medium-term, net borrowing (borrowings less investments) will only be for a capital purpose. Net external borrowing should not, except in the short-term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2018/19 and next 2 financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need, which will be adhered to if this proves prudent.

18. The Assistant Director Resources reports that no difficulties are envisaged for the current or future years in complying with this PI.

19. A further PI controls the overall level of borrowing. This is the Authorised Limit (AL), which represents the limit beyond which borrowing is prohibited and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short-term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under Section 3 (1) of the Local Government Act 2003.

20. The Operational Boundary links directly to the Council's estimates of the CFR and estimates of other cash flow requirements. This indicator is based on the same estimates as the AL, reflecting the most likely but not worst case scenario, but without the additional headroom included in the AL.

Authorised limit	2017/18 Actual £'000	2018/19 Estimate £'000	2019/20 Estimate £'000	2020/21 Estimate £'000
Debt	24,400	26,600	35,400	56,300
Other long term liabilities	0	0	0	0
Total	**24,400**	**26,600**	**35,400**	**56,300**

Operational boundary	2017/18 Actual £'000	2018/19 Estimate £'000	2019/20 Estimate £'000	2020/21 Estimate £'000
Debt	22,000	24,000	32,000	51,000
Other long term liabilities	0	0	0	0
Total	**22,000**	**24,000**	**32,000**	**51,000**

21. The maximum cash outflow in a month, plus potential short-term borrowing is estimated to be around £24m and this leads to the Operational Boundary quoted above.

22. Appendix 2 shows the latest approved list of countries for investments.

Conclusion

23. The Council's current treasury management and investment strategies remain robust in managing the Council's cash funds. The economic outlook remains difficult for a net investor such as the Council and supports the Council's financial strategy to reduce reliance on investment returns.

Malcolm Johnston
Executive Director

Risk Assessment Statement
There are no direct risks arising from this report. Failure to follow the Council's investment strategy could increase the risk of financial loss.

Link Asset Services – Economic Commentary 13 August 2018

Economic Background

1. **UK** – Halifax reported that house prices picked up in July, rising 1.4% m/m which pushed the annual rate to 3.3%, the highest since November. Q2 GDP growth picked up to 0.4% q/q, from 0.2% in Q1, which lifted the annualised rate by a point to 1.3%, just higher than the six year low of Q1. The June trade deficit narrowed to £1.28bn as export growth exceeded that of imports. Overall industrial production grew 0.4% m/m, after contracting in May, to put annual growth at a slightly lower 1.1%.

2. **US** – Levels of consumer credit grew by less than expected in June. The rise of $10.21bn compared to a downwardly revised $24.26bn the previous month, and was below the market expectation of $15.25bn. Annual CPI was unchanged at 2.9% in July, which is the highest level since February 2012. Core inflation, though, picked up slightly to 2.4%, its highest since September 2008.

3. **EZ** – German industrial orders slumped by 4% in June, far more than expected, having jumped by 2.6% in May. Output fell for consumer, capital and intermediate goods but construction activity contracted.

4. **Global –** Core Japanese machinery orders plunged by far more than forecasters predicted for June. It is the third decline in four months with manufacturing orders particularly hard hit. Real wages in the economy are rising at the fastest pace in more than twenty one years, which should bolster consumer spending and prospects for inflation.

Investments

LIBOR – The money market yield curve fell marginally over the week. The one-month rate pushed up slightly to 0.7221%, while the 1yr rate was down to 1.041%.

5. **Money Market Funds** – The average yield for Government Funds picked up greatly by 10bps to 67bps. On the other hand, that for Liquidity Funds rose by 5bps to 67bps. Assets under Management saw a c£0.5bn drop for liquidity funds as investors sought higher yields elsewhere, whilst MMFs adjust to new rates.

6. Market expectations for a rate hike for the rest of the year remain below 10%. BOE policy makers are trying to strike a balance between taming inflation as the economy runs out of slack and protecting against the risk of Brexit affecting growth.

7. Counterparty quality and suitable limits remain key factors when making investment decisions.

Risk Analysis

8. European and US CDS prices picked up by 9% and 4.4% respectively over the week. For the month, these numbers are now up 11.9% and 1.5% respectively. Geopolitical tensions continue to be an area creating investor caution.

9. Major equity indices were all down on the week, with EU banks taking a -3.7% hit and world banks taking a 2% hit on the week. Investors were cautious towards risk assets last week as concerns for Turkey raised queries as to whether these issues would spread through the EU.

Debt Markets

10. Gilt yields fell gradually finishing 6-7bp down from the start of the week; this is believed to be due to uncertainty over Brexit negotiations.

11. PWLB rates remain below our trigger levels across the curve.

<u>Interest Rate Forecast</u>

12. The Council's treasury advisor, Link Asset Services, has provided the following forecast:

PWLB (Includes Certainty Rate)					Forward Rates			
1y	5y	10y	25y	50y	3M/3M FWD	3M/6M FWD	3M/9M FWD	6M/12M FWD
1.39	1.76	2.18	2.58	2.36	0.81	0.87	0.93	1.08

Interest Rate Forecasts

Bank Rate	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20
Link	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%
Cap Econ	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%	1.50%
5Y PWLB RATE								
Link	2.00%	2.00%	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%
Cap Econ	1.95%	2.15%	2.20%	2.30%	2.35%	2.40%	2.40%	2.40%
10Y PWLB RATE								
Link	2.40%	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.90%
Cap Econ	2.40%	2.55%	2.60%	2.70%	2.75%	2.80%	2.80%	2.80%
25Y PWLB RATE								
Link	2.80%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%
Cap Econ	2.90%	3.05%	3.10%	3.20%	3.25%	3.30%	3.30%	3.30%
50Y PWLB RATE								
Link	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%
Cap Econ	2.95%	3.10%	3.15%	3.25%	3.30%	3.35%	3.35%	3.35%

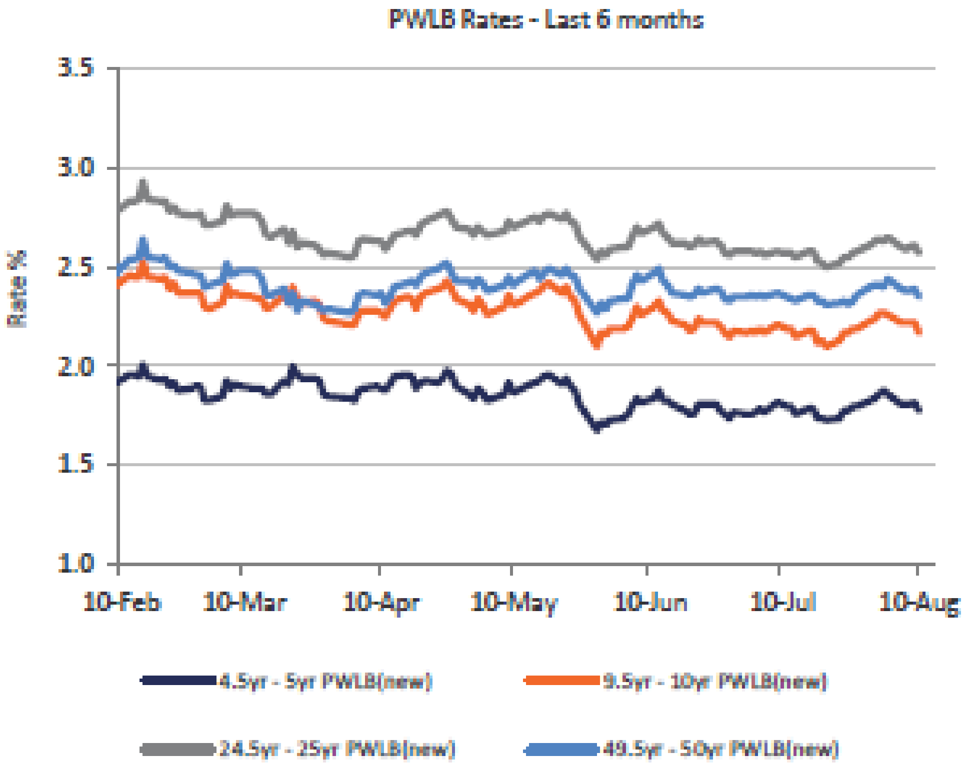
13. The August MPC meeting delivered the expected 25 basis point rate hike, to 0.75%, but the 9-0 outcome was a surprise. The committee reaffirmed that further rate moves will likely be gradual, though inflationary pressures will be monitored. The markets are not factoring in another rate hike at any of the last three meetings this year, with December expectations being pared back below 10% following comments from the BoE Governor on Brexit. August is being priced in as the likely timing of the next rate hike.

New Borrowing

14. Due to the overall financial position and the underlying need to borrow for capital purposes (the Capital Financing Requirement - CFR), new external borrowing of £0.900m was undertaken in July 2018 from the PWLB / Market at a rate of 2.585%.

15. It is anticipated that further borrowing may be undertaken during this financial year.

16. This Council has not borrowed in advance of need during the period to the end of July 2018.



Approved countries for investments as at 30.06.2018

Since publication of the Treasury Management Strategy and annual Investment Strategy in February 2018, the approved list of countries has changed as detailed below.

Based on lowest available rating:

AAA

- Australia
- Canada
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- Finland
- U.S.A.

AA

- Abu Dhabi (UAE)
- France
- Hong Kong
- U.K.

AA-

- Belgium
- Qatar