Rother District Council

Report to	-	Audit and Standards Committee
Date	-	9 December 2019
Report of the	-	Executive Director
Subject	-	Treasury Management Report update

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

Assistant Director Resources – Robin Vennard

Introduction

1. Council approved the Council's 2019/20 Investment Strategy in February 2019 (Minute CB18/66 refers). 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 using Capital Receipts).

3. The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management recommends that Members be updated on treasury management activities regularly. This report, therefore, ensures this Council is implementing best practice in accordance with the Code.

<u>Economic Update</u>

4. Bank of England (BoE) base rate remains at 0.75% and is due for review on the 19 December. At its last meeting on the 6 November the Monetary Policy Committee (MPC) voted by a majority of 7-2 to maintain bank rate at its current level. The BoE comment that underlying UK GDP growth has slowed materially this year reflecting weaker global growth, driven by trade protectionism, and the domestic impact of Brexit-related uncertainties. In October, the UK and EU agreed a Withdrawal Agreement and Political Declaration as well as a flexible extension of Article 50. As a consequence, the sterling exchange rate has appreciated and these agreements are expected to remove some of the uncertainty facing businesses and households. The MPC

projects that UK GDP growth will pick up during 2020 supported by easier UK fiscal policy and a modest recovery in global growth.

5. Inflationary pressures are projected to lessen in the near term. CPI inflation remained at 1.7% in September and is expected to decline to around 1¼% by the spring, CPI inflation has begun to increase, employment growth has slowed and pay growth is likely to fall back in the near term. In the second half of the MPC's forecast period, however, due to an expected excess in demand, domestic inflationary pressures are expected to build. CPI inflation is projected to rise to slightly above 2%. The financial forecast assumes inflation of 2% so there may be additional cost pressures for major contracts next financial year.

Financial Investments review

6. The Council currently makes most of its investments through the use of call and deposit accounts with the major financial UK institutions. In addition to this the Council has invested £5m in the Churches, Charities, Local Authorities' (CCLA) Property Investment Fund and £3m in the HERMES Property Investment Fund.

7. As at 30 November 2019 the Council's total investments were £32,083,554. There was £12,045m of borrowing at 31 July 2019 and the Capital Financing requirement was £16.7m.

8. The Council's investment policy is governed by Ministry of Housing, Communities and Local Government investment guidance, which has been implemented in the annual investment strategy approved by the Council in February 2019. This policy sets out the approach for choosing investment counterparties and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data, (such as rating outlooks, credit default swaps, bank share prices etc.).

9. The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

10. The total income from investments is estimated at £492,000 with an average rate of return on investments of 1.89%. This is slightly below the annual budget of £512,000.

11. The investment portfolio as at 30 November 2019: to be updated

12.

Deposit with	Type of account	Maturity Date	Amount £	Deposit	%
Lloyds (RFB)	Call Account		4,590,840	0.65%	14.31%
Bank of Scotland (RFB)	32 Days' notice		5,000,000	0.90%	15.58%
Bank of Scotland (RFB)	Call Account		6	0.65%	0.00%
Barclays (RFB)	Call Account		1,060	0.50%	0.00%
Santander	Call Account		1,650	0.55%	0.01%
Lloyds (RFB)	Deposit	17/01/2020	1,000,000	1.00%	3.12%
Lloyds (RFB)	Deposit	24/04/2020	2,000,000	1.25%	6.23%
Lloyds (RFB)	Deposit	08/05/2020	1,000,000	1.25%	3.12%
Lloyds (RFB)	Deposit	20/03/2020	4,000,000	0.85%	12.47%
Bank of Scotland (RFB)	Deposit	03/02/2020	1,500,000	1.05%	4.68%
Santander	Deposit	06/12/2019	1,500,000	0.90%	4.68%
Santander	Deposit	15/01/2020	2,500,000	1.00%	7.79%
Santander	Deposit	14/02/2020	990,000	1.00%	3.09%
HERMES Property Fund*	Long Term		2,999,998	3.01%	9.35%
CCLA Local Authority Property Fund*	Long Term		5,000,000	4.32%	15.58%
Total			**32,083,554**		100%
Total managed in-house			24,083,556		
Total managed externally			7,999,998		
Total Treasury Investments			**32,083,554**		

Borrowing

13. The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). The figure is a gauge of the Council's indebtedness. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represents the 2019/20 unfinanced capital expenditure and prior years' net or unfinanced capital expenditure which has not been paid for by revenue or other resources.

14. Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure that enough cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies, such as the Government, through the Public Works Loan Board (PWLB), or the money markets, or utilising temporary cash resources within the Council.

15. The Council's underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision (MRP), to reduce the CFR. This is effectively a repayment of the borrowing need. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

16. The total spend and funding of the Capital Programme for 2019/20 is summarised in the table below:

	2019/20 Budget £ (000)	2019/20 Revised Budget £ (000)	2019/20 Estimated Outturn £'000
Capital Expenditure	**21,205**	**17,945**	**17,945**
Financing			
Capital Receipts	1,930	1,118	1,118
Grants and contributions	3,847	2,995	2,995
Borrowing	13,758	13,078	13,078
Capital Expenditure Charged to Revenue	1,670	754	754
Total Funding	**21,205**	**17,945**	**17,945**

17. The capital programme assumes new borrowing in 2019/20 of £13.078m and this increases the Council's CFR for the year as shown below:

	2019/20 Budget £'000	2019/20 Revised Budget £'000	2019/20 Estimated Outturn £'000
Opening balance	3,650	3,756	3,756
Add unfinanced capital expenditure	16,136	13,078	13,078
Less MRP/VRP	(156)	(108)	(108)
Closing balance	**19,630**	**16,726**	**16,726**

18. At the 30 November 2019 the Council's actual borrowing position was as follows:

Borrowing position as at 30 November 2019

PWLB Ref:	Amount o/s	Interest rate	Term	Type	Full year Repayments
507499	447,776.00	2.59%	50	Annuity	16102.16
507503	447,770.00	2.58%	50	Annuity	16070.34
509130	1,650,000.00	2.39%	50	Annuity	56729.24
509131	1,000,000.00	2.24%	50	Maturity	22,400.00
509165	8,500,000.00	2.48%	50	Annuity	297571.66
Total Borrowing	12,045,546.00	2.46%			408,873.40

19. Borrowing activity is constrained by prudential indicators for gross borrowing and the CFR, and by the authorised limit. The authorised limit is the "affordable borrowing limit" required by Section 3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level. The table below demonstrates that during 2019/20 the Council plans to maintain gross borrowing within its authorised limit.

Treasury Indicators	**Original 2019/20 Budget £'000**	**Revised Actual (Apr to Jul) £'000**
Authorised limit for external debt	20,000	57,400
Operational boundary for external debt	10,000	52,000
5Gross external debt (actual)	12,488	12,046
Investments		32,084
Net borrowing/ (investment)		**(20,038)**

20. The operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary are acceptable subject to the authorised limit not being breached.

21. The actual financing costs as a proportion of net revenue stream identifies the trend in the cost of capital, (borrowing and other long term obligation costs net of investment income), against the net revenue stream.

Prudential indicators	**2019/20 Budget £'000**	**2019/20 Estimated Outturn £'000**
Capital expenditure charged to the general fund	1,670	704
Capital Financing Requirement (CFR)	19,630	16,726
Annual change in CFR	15,980	12,970
In year borrowing requirements	12,488	13,078
Ratio of financing costs to net revenue stream %	0.53%	(0.79)%

22. During 2019/20, the Council has maintained an under-borrowed position. This means that the need for borrowing, (the CFR), was not fully funded with loan debt, as cash supporting the Council's reserves, balances and cash flow was used as an interim measure. This strategy is prudent as investment returns are

low and minimising counterparty risk on placing investments also needed to be considered.

Non-Treasury Investments

23. The Council continues to invest in the economic regeneration of Rother through its Property Investment Strategy (PIS) and the expected income from these non-Treasury Investments is estimated as follows.

	2019/20 Estimated Property Investment Income		
Property	**Income Property Investment Strategy**	**MRP & interest**	**Net Income**
14 Terminus Road*	106,000	(32,091)	73,909
18-40 Beeching Road*	87,684	(48,435)	39,249
16 Beeching Road*	97,000	(48,435)	48,565
Glovers House	389,583	(190,133)	199,450
Total	680,267	(319,094)	361,173

* Ground rent included in rental income

24. The budget for rental income from all investment properties is £1,939,000. This is made up of £975,000 for the existing assets and £964,000 for the properties purchased through the property investment strategy. The latest estimated outturn for 2019/20 is £1,531,200 a shortfall of £408,550. This equates to a 6.6% gross return on the value of all properties including those purchased under PIS. After allowing for borrowing costs these properties are generating an expected return of 2.92%. The Property Investment Panel met on the 14 November 2019 and considered the purchase of a property in Battle at an expected cost of £3.075m plus costs of purchase. The purchase is currently going through its due diligence and legal process. Further details of the PIS purchases in 2019/20 will be presented to Members at their next meeting.

25. The performance of the non-Treasury investments can be summarised in the table below and excludes the expected purchase quoted above: -

Property	**2019/20 Budget £ (000)**	**2019/20 Estimated Outturn £'000**	**Variation**
14 Terminus Road*	74	74	-
18-40 Beeching Road*	39	39	-
16 Beeching Road*	49	49	-
Glovers House	199	199	-
Future properties	232	0	(232)
Total	593	361	(232)

New CIPFA Guidance

26. New guidance on non-treasury investments has been published by CIPFA. This guidance is currently being reviewed to consider if there is an impact on the Council's PIS. It should be noted that this is only guidance and does not change the underlying legislation that the Council is relying on for its PIS.

Conclusion

27. The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties. The investment environment for treasury activities remains very difficult with absolute returns continuing to be very low. The diversification into Property Funds has increased the net overall return but does come with a greater degree of capital risk than other investments and is less liquid. The Council's PIS has regeneration at its heart and is planned to generate returns in excess of 2% (net of borrowing costs), which is greater than predicted for treasury investments. Again this comes with greater risk due to the commitment to repaying borrowing and the direct operational risks of managing property.

Malcolm Johnston
Executive Director

Risk Assessment Statement
The risks arising from the Councils treasury investments and its non-Treasury investments are outlined in this report. Failure to follow the Council's investment strategy could increase the risk of financial loss