

Rother District Council

Report to	-	Audit and Standards Committee
Date	-	18 May 2020
Report of the	-	Executive Directors
Subject	-	Treasury Management Update

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

Assistant Director Resources: Robin Vennard

Introduction

1. Cabinet approved the Council's 2019/20 Investment Strategy on the 11 February 2019. 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.

Economic Update

4. The UK has now formally left the EU although transition terms are in place, meaning no actual change to trading conditions. The UK Government has indicated that it wishes to strike a trade deal by the end of 2020 and if a broad outline has not been agreed by June it will walk away from trade talks, which would result in a 'no deal' outcome.
5. The onset of the coronavirus is having a major impact on global markets, particularly in China where the virus appears to have originated and where its impact has been greatest.

6. In January 2020, the Bank of England's Monetary Policy Committee voted not to cut its base interest rate whilst indicating that a cut remained a possibility later in the year. However on the 11 March 2020 they made an emergency announcement to cut the base rate from 0.75% to 0.25% to try and mitigate the economic impact of the Coronavirus on the UK. We will continue to take advice from the Council's asset management specialists, LINK Asset Services, regarding base rate forecasts as they could be subject to further changes arising from Brexit trade deal negotiations and other global events.
7. Economic data releases have shown some positive signs in recent weeks with the outcome of the General Election providing far greater political certainty. CPI inflation remains low at 1.1% although UK GDP quarterly growth slowed to an average of 0.2% in 2019. However, economic forecasts have recently been more pessimistic following the above-mentioned coronavirus outbreak.

Financial Investments Review

8. The Council currently makes the majority of its investments through the use of call and deposit accounts with the major financial UK institutions. In addition, the Council holds investments totalling £8m in Property Funds.
9. As at 30 November 2019 the Council's total investments were £28,798m. There was £11,984m of borrowing as at the 29 February 2020 and the Capital Financing requirement was £17,267m.
10. 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 Cabinet on the 10th February 2020. 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.).
11. The investment activity during the year conformed to the approved strategy and the Council had no liquidity difficulties.
12. The total income from investments is estimated at £512,000 with an average rate of return on investments of 1.83%.
13. The investment portfolio as at the 2 March 2020 is shown in the table overleaf:

Deposit	Type of account	Maturity Date	Amount £	Interest Rate	Share %
Lloyds - General (RFB)	Call	N/A	10,794,445	0.65%	37.48%
Lloyds - (RFB)	Fixed	24/04/2020	2,000,000	1.25%	6.95%
Lloyds - (RFB)	Fixed	08/05/2020	1,000,000	1.25%	3.47%
Lloyds - (RFB)	Fixed	20/03/2020	4,000,000	0.85%	13.89%
Bank of Scotland (RFB)	Call	N/A	6	0.65%	0.00%
Bank of Scotland	32 Days Notice	N/A	3,000,000	0.90%	10.42%
Barclays - Call Account (NRFB)	Call	N/A	1,065	0.50%	0.00%
Santander - 31 Day Notice Account	31 Days Notice	N/A	1,653	0.55%	0.01%
CCLA Local Authority Property Fund	Long Term	N/A	5,000,000	4.32%	17.36%
HERMES Property Fund	Long Term	N/A	2,999,998	3.01%	10.42%
Total			28,797,166		100.00%
Total managed in-house			20,797,169		
Total managed externally			7,999,998		
Total Treasury Investments			28,797,166		

Borrowing

14. 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.
15. Part of the Council's treasury activities is to address the funding requirements for the 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.
16. The Council's 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 be borrowed or repaid at any time, but this does not change the CFR.
17. The total expenditure and funding of the Capital Programme for 2019/20 is summarised in the table overleaf:

	2019/20 Original Budget £ (000)	2019/20 Revised Budget £ (000)	2019/20 Estimated Outturn £ (000)
Capital Expenditure	21,205	17,245	17,534
Financing:			
Capital Receipts	1,930	415	415
Grants and Contributions	3,847	2,859	2,876
Borrowing	13,758	13,313	13,452
Capital Expenditure Charged to Revenue	1,670	658	791
Total Funding	21,205	17,245	17,534

18. The capital programme assumes new borrowing in 2019/20 of £13.602m and this increases the Council's CFR for the year as shown below:

	2019/20 Original 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	13,313	13,452
Less Minimum Revenue Provision (MRP)	(156)	(91)	(91)
Closing Balance	19,630	16,978	17,117

19. At the 29 February 2020, the Council's actual borrowing position was as follows:

Borrowing position as at the 29 February 2020					
PWLB Ref:	Amount o/s	Interest Rate	Term	Type	Full Year Repayments
507499	£443,243	2.59%	50	Annuity	£16,102
507503	£443,223	2.58%	50	Annuity	£16,070
509130	£1,641,250	2.39%	50	Annuity	£56,729
509131	£1,000,000	2.24%	50	Maturity	£22,400
509165	£8,451,646	2.48%	50	Annuity	£297,572
Total Borrowing	£11,979,362	2.46%			£408,873

20. 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	2019/20 Original Budget £ (000)	Actual as at 29 February 2020 £ (000)
Authorised Limit for External Debt	20,000	57,400
Operational boundary for External Debt	10,000	52,000
Gross External Debt (actual)	12,488	11,980
Investments	(22,096)	(28,798)
Net Borrowing/(Investments)	(9,608)	(16,818)

21. 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.
22. 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 Original Budget £ (000)	2019/20 Estimated Outturn £ (000)
Capital Expenditure Charged to Revenue	1,670	791
Capital Financing Requirement (CFR)	19,630	17,117
Annual Change in CFR	15,980	13,361
In-Year Borrowing Requirements	12,488	11,980
Ratio of Financing costs to Net Revenue Stream %	0.53%	-1.64%

23. The Council has maintained an under-borrowed position this year, which means that the CFR was not fully funded with loan debt, as cash supporting the Council's reserves, balances and cash flow was used instead. This strategy is prudent as investment returns remain low and counterparty risk on placing investments is minimised.

Non-Treasury Investments

24. 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	Rental Income £	MRP & Interest £	Net Income £
14 Terminus Road	106,000	(16,102)	89,898
18-40 Beeching Road	86,394	(16,070)	70,324
16 Beeching Road	97,000	(28,364)	68,636
Glovers House	401,750	(148,786)	252,964
Market Square, Battle	56,096	0	56,096
Total	747,240	(209,322)	537,918

25. In addition to the above properties the Council has also purchased a property in Barnhorn Green, which should bring in further rental income in the future.
26. Since the last report to Audit and Standards Committee on the 9 December 2019, the Council has purchased Market Square in Battle at a total cost of £3.221m including the costs of purchase. The budget for rental income from all investment properties is £1,939,750. This is made up of £975,670 for the existing assets and £964,080 for the properties purchased through the PIS. The latest estimated outturn for 2019/20 is £1,695,405 a shortfall of £244,345. This equates to a 5.8% gross return on the value of all properties including those purchased under PIS. After allowing for borrowing costs the return on PIS properties is generating an expected return of 2.54%.

New CIPFA Guidance

27. New guidance on non-treasury investments has been published by CIPFA. This guidance is currently being reviewed to consider its impact on the PIS. It should be noted that this is only guidance and does not change the underlying legislation that the Council looks to comply with regarding its PIS.

Conclusion

28. 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

Dr Anthony Leonard
Executive Director

Risk Assessment Statement

The risks arising from the Council's 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.