Finance Sub-Committee – 11 September 2017

Treasury Management Report to 31 July 2017

Purpose of report

The purpose of this report is to note the current position for Treasury Management for the period to 31 July 2017 in financial year 2017/18.

Attachment(s)

Appendix 1: Prudential Indicators – as at 31 July 2017

1. Introduction

1.1. The Treasury Management Strategy for 2017/18 was approved as part of the Medium Term Financial Strategy (MTFS) in February 2017. It was underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2009.

1.2. The CIPFA Code of Practice recommends that Members be informed of treasury management activities at least twice a year; this report therefore embraces best practice.

1.3. The report provides:
- A summary of the economic conditions affecting the council's investment strategy
- Details of investments made during the year
- A summary of the council's current investment portfolio

1.4. The council's investment priorities are:
- Security of capital invested
- Liquidity of capital invested
- Return on investment

2. Market Conditions

2.1. **Growth:** Change in gross domestic product (GDP) is the main indicator of economic growth. GDP was estimated to have increased by 0.3% in the period Apr to June 2017 compared with growth of 0.2% in the period Jan to Mar 2017.
Growth in the EU improved in 2016, to 1.7%, after the ECB cut rates into negative territory and embarked on massive quantitative easing during the year. The ECB is now forecasting growth of 1.9% in 2017, 1.8% in 2018 and 1.7% in 2019. It has committed to continuing major monthly quantitative easing purchases of debt instruments, though in April 2017 it reduced the rate from €80bn per month to €60bn, to continue until the end of 2017, in order to stimulate growth and to get inflation up to its 2% target.

GDP growth in the US has been highly volatile in 2016 but overall mediocre, at an average of 1.6% for the year. Quarter 1 in 2017 has also been mediocre at 1.4% but current indications are that growth could rebound strongly in quarter 2. The disappointment so far has been the lack of decisive action from President Trump to make progress with his promised fiscal stimulus package. The Fed has, therefore, started on the upswing in rates now that the economy is at or around "full employment" and inflationary pressures have been building to exceed its 2% target. It has, therefore, raised rates four times, with the last three following quickly on one another in December 2016, March 2017 and June 2017. One or two more increases are expected in 2017 and possibly another four in 2018.

2.2. **Inflation:** The official Inflation Report showed the Bank of England (BoE) left its forecast for growth this year unchanged at 2%. The Consumer Prices Index (CPI) fell to 2.6% in the year to July 2017, whilst the figure for the month was recorded at 0%. A key contribution to this fall is the reduction in oil prices.

2.3. **Monetary Policy:** The Monetary Policy Committee (MPC) held a majority vote of 6-2 to maintain the bank rate at 0.25%. It also voted unanimously to maintain the stock of UK government bond purchases (Quantitative Easing programme) at £435bn.

Provided those cost pressures do not feed through into significantly higher domestically generated inflation within the UK, the MPC is expected to ‘look through’ this one off blip upwards in inflation. There is, though, a potential risk that the MPC might muster a majority to reverse the emergency 0.25% rate cut before embarking on a progressive trend of increases in Bank Rate at a later time.

2.4. **Interest Rates:** The latest forecast for interest rates, based on information from the council’s Treasury Management advisors, is shown below:

Official Bank Rate	Q2 17	Q4 17	Q1 18	Q2 18	Q3 18	Q4 18	Q1 19	Q2 19	Q3 19
Capita	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.50

Treasury Management Activity

2.5. During the first four months of the 2017/18 financial year, the opportunity for the council to invest its surplus cash for periods beyond 3 to 6 months in duration has remained limited. This has mainly been due to the impact of the uncertainty in the lead up to the UK leaving the EU.

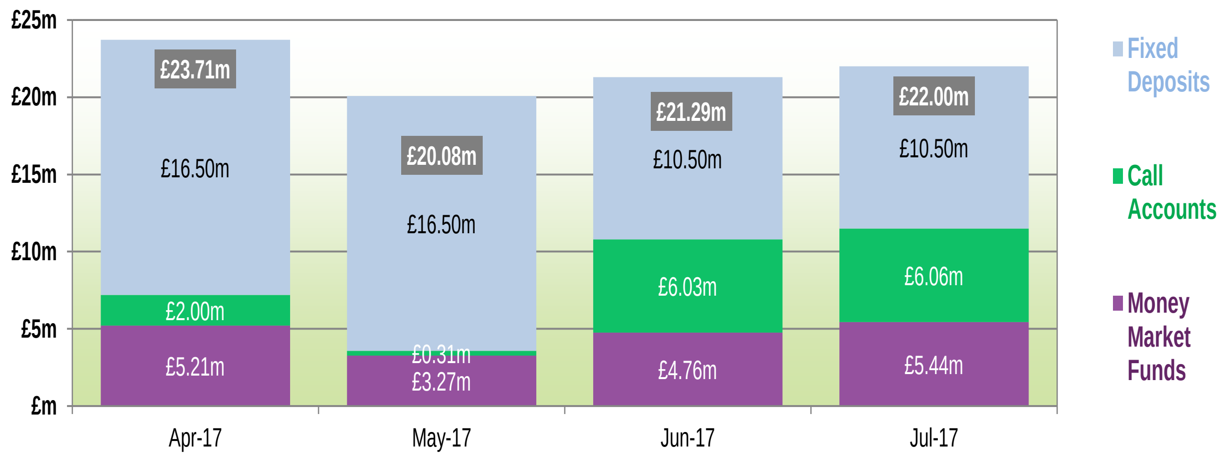
2.6. Investing for shorter durations reduces the counterparty risk the council is exposed to and the potential yield (interest rate) the council can achieve. However, since the impact of the EU Referendum vote and the Bank of England’s decision to reduce the interest rate to 0.25%, any yield achievable on surplus cash balances will be severely reduced. To mitigate some of the impact of reduced rates, the council opted for fixed term deposits, by investing in a 95 day and a 180 day notice account, which (at present) is yielding 0.46% to 0.65%.

2.7. The council will continue to monitor the economic outlook and money markets to ensure it is able to achieve a yield in line with market expectations whilst ensuring security and liquidity of capital are maintained.

2.8. Future investment decisions are discussed between the Treasury Manager and Finance Manager and are made in line with the Annual Treasury Management Strategy and the advice from the council’s Treasury Management Advisors.

2.9. The chart below demonstrates the change in investment by type up to 31 July 2017.

Total amount invested July 2017



2.10. Call accounts and Money Market Funds (MMF) are very short term, liquid investments. They are generally overnight deposits or short term notice accounts where the balance invested can be withdrawn immediately. Fixed Deposits are investments with a longer duration, where cash is invested for a contractually agreed period with no opportunity to withdraw cash prior to the maturity date of the deposit.

2.11. The level of cash balances held by the council has decreased since April 2017 by £1.71m, due to a one off capital purchase in May of £3.9m.

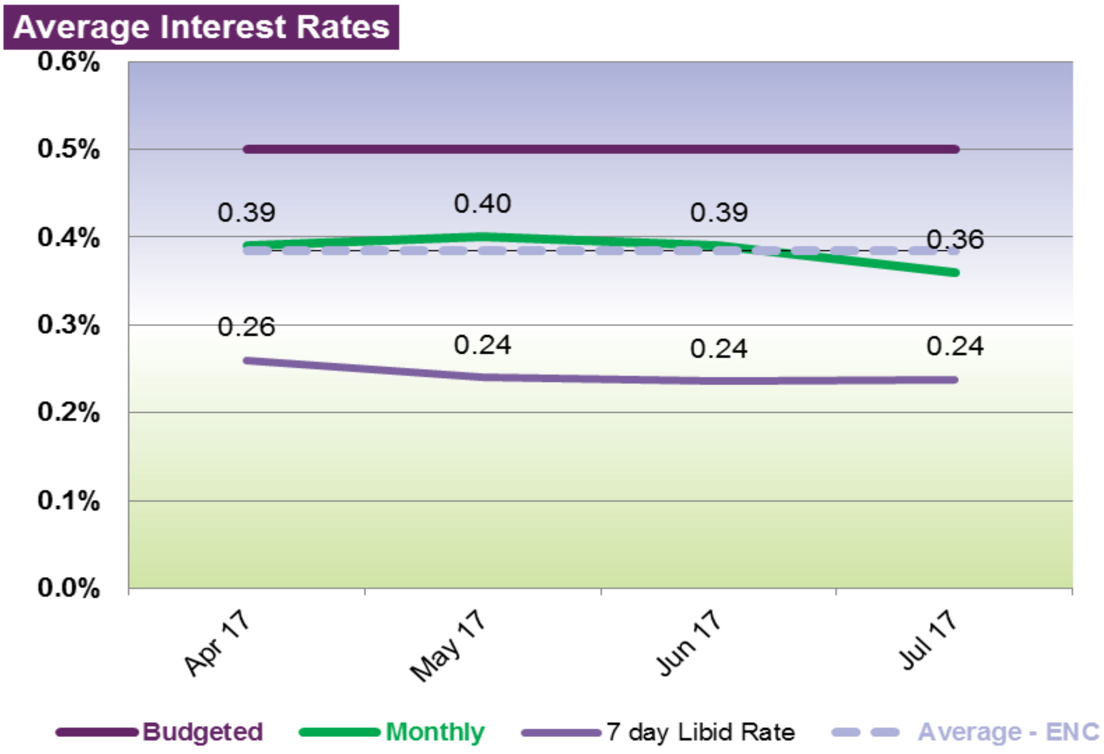
3. Treasury Management Position and Performance

3.1. The table below summarises the council's current portfolio of investments as at 31 July 2017.

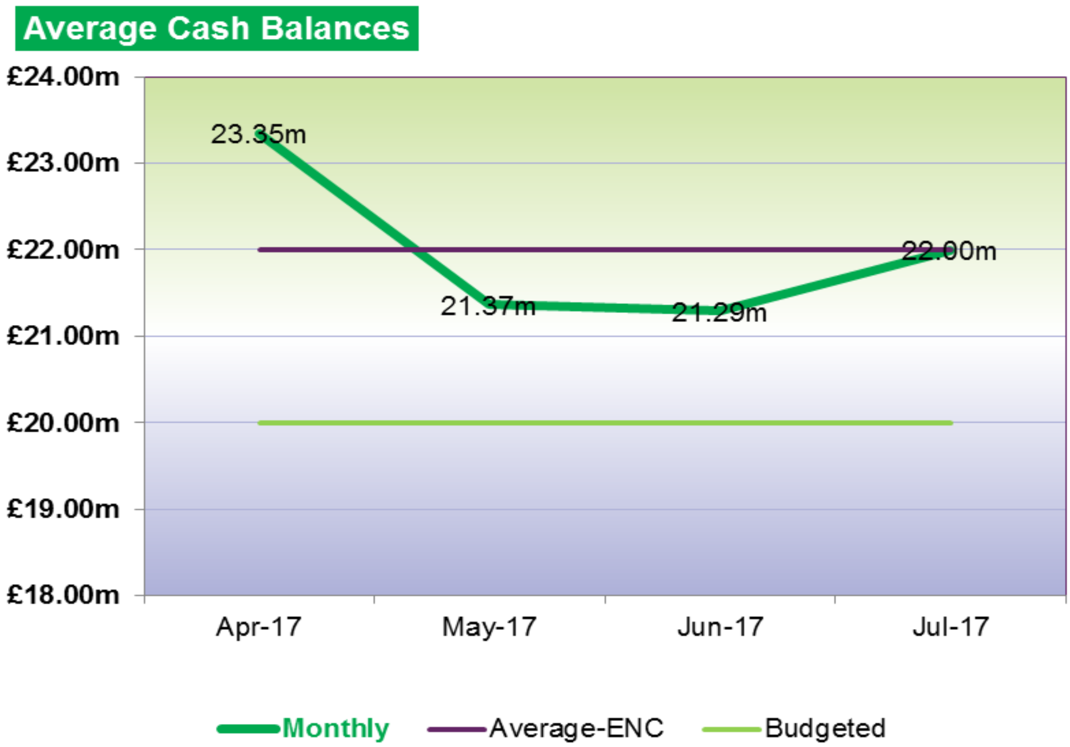
Counterparty / Lender	Amount	Rate %	Maturity Date
Call Accounts			
Santander UK (95 Day notice)	£1,500,000	0.45	
Santander UK (180 Day notice)	£1,500,000	0.55	
Goldman Sach's (180 Day notice)	£3,000,000	0.65	
Barclays Bank Current Account	£60,626	0.05	
Money Market Funds			
Federated Sterling Liquidity Fund (Money Market Fund)	£2,996,979	0.22	
Deutsche Bank Sterling Fund (Money Market Fund)	£2,440,782	0.14	
Fixed Term Deposits			
Thurrock Borough Council	£1,500,000	0.23	27/10/2017
Coventry Building Society	£3,000,000	0.35	11/01/2018
Lloyds Bank	£2,000,000	0.55	25/10/2017
Lloyds Bank	£1,000,000	0.36	19/12/2017
Nationwide Building Society	£3,000,000	0.32	04/01/2018
	£21,998,388		

3.2. The average return on the council's portfolio to 31st July 2017 is 0.36%. This is 0.12% above the average 7-day London Interbank Bid Rate (LIBID) of 0.24%.

3.3. The council's current interest rate achievable on its investment portfolio is lower than anticipated when the budget was set in February 2017. At that time, the expected average rate was 0.50%. This is demonstrated in the table below:



3.4. Whilst the council's investments are achieving lower rates of return, the level of cash balances held by the council is higher than anticipated when the budget was set in February 2016, as demonstrated in the table below. The majority of the increase in cash balances is due to the timing of Council Tax and Business Rates receipts and slippage within the Capital Expenditure Programme.



3.5. For 2017/18, the interest receivable is expected to be below budget by approximately £3k.

3.6. The council continues to make use of its surplus monies, meaning there has been no requirement to undertake any external borrowing. Consequently, no interest payable has been incurred during this period.

3.7. The Council's surplus monies of £22m primarily arise from two sources. Firstly, its cash backed reserves, and secondly, its positive working capital position.

3.8. The Council is currently considering how it can optimise its treasury management activities between security, liquidity and yield. A core part of this review is the level of cash backed reserves the Council has for treasury management purposes in the short and longer term. This depends upon how the Council intends to use its reserves. As the Council is currently preparing a set of investment principles, which will be considered by the relevant committee in due course, this may lead to the Council utilising some of its reserves by investing them in tangible assets. The treasury management approach has been to invest monies as set out in Section 2 of this report. Following the outcome of these investment principles, the strategy for investing surplus monies will be reconsidered depending upon if the level of surplus monies will be maintained or reduced.

3.9. The overall Treasury Management outturn is set out below.

Treasury Management Budget vs. Estimated Outturn				
	Budget	Estimated Outturn	Shortfall	
	£	£	£	
Investments	£100,000	£95,633	(£4,367)	Lower interest rates being achieved, partly offset by higher than expected cash balances
Total	**£100,000**	**£95,633**	**(£4,367)**	

4. Prudential Indicators

4.1. Prudential Indicators look at the council's capital expenditure in terms of affordability and sustainability over the medium term and in particular the impact of these capital investment decisions on Council Tax. Details of each of the prudential indicators are shown in **Appendix 1.**

4.2. A key indicator for the council is the Ratio of Financing Costs to Net Revenue Stream. As the council has no external borrowing, the indicator for affordability is zero which is line with what was estimated. Further detail on this indicator can be seen in appendix 1 (paragraph 1).

4.3. Another key indicator for the council is the Incremental Impact of Capital Investment Decisions on cash surpluses, which is prescribed by the prudential code. This shows the impact of the capital investment in terms of the potential increase in the Council Tax funding requirement, i.e the opportunity costs (interest receivable) of not being able to invest these surplus funds elsewhere. During 2017/18 the council has increased its investment within the capital programme and therefore the impact on Council Tax has increased. However this does not take into consideration the revenue benefit of additional rental income that the Council will receive, of approximately £280k pa achieving a return on capital investment of 8% and reducing the overall burden on Council Tax funding requirements. Additionally, the interest rate foregone is lower than budgeted at 0.36% compared to 0.50%. The reduction in interest rates has allowed the council to ensure its capital expenditure remains affordable and sustainable. Further detail can be found in appendix 1 at paragraph 3.

	2017/18 Estimate	2017/18 Actual
Capital Expenditure	£1,804,005	£6,172,672
Increase in Band D Council Tax	0.29p	0.72p

5. Equality and Diversity Implications

5.1. This report is for information. There are no equality and diversity implications arising from the content.

6. Legal Implications

6.1. This report is for information. There are no legal implications arising from the content.

7. Risk Management

7.1. This risks arising from Treasury Management activity are recorded in the Risk Register. The risks are subject to regular review and update.

8. Resource and Financial Implications

8.1. This report is for information, there are no financial implications arising from this report.

9. Constitutional Implications

9.1. This report does not require any amendment to the Council's Constitution.

10. Implications for our Customers

10.1. There are no implications for our customers arising directly from this report.

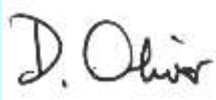
11. Corporate Outcomes

- ***Good Value for Money***
  This report demonstrates that the council is ensuring it effectively manages its surplus cash to achieve good value for money for the Council
- ***Effective Management***
  Treasury Management allows the council to manage its surplus cash balances to ensure the main principles (Security, Liquidity, and Yield) are maintained, contributing to effective management of the council

12. Recommendations

12.1. Finance Sub-Committee is recommended to note the Treasury Management performance for period up to 31 July 2017 in financial year 2017/18.

(Reason – in accordance with CIPFA guidance and best practice in Treasury Management)

<table>
<tr><td rowspan="2">Legal</td><td colspan="5">Power: Local Government Finance Act 2002</td></tr>
<tr><td colspan="5">Other considerations: Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2009.</td></tr>
<tr><td colspan="6">Background Papers:</td></tr>
<tr><td colspan="6">Person Originating Report: Michelle Drewery, Finance Manager, 01832 742267
mdrewery@east-northamptonshire.gov.uk</td></tr>
<tr><td colspan="6">Date: 15/08/2017</td></tr>
<tr><td>CFO
29/8/17</td><td></td><td>MO</td><td></td><td>CX
24/8/17</td><td></td></tr>
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Appendix 1

Prudential Indicators – as at 31 July 2017

1. Ratio of Financing Costs to Net Revenue Stream

This is an indicator of affordability, and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet borrowing costs. The definition of financing costs is set in the Prudential Code.

Ratio of Financing Costs to Net Revenue Stream	2017/18 Estimate %	2017/18 Estimate (Revised) %
General Fund	0.00	0.00
Total	**0.00**	**0.00**

As the council has no external borrowing the indicator is zero, in line with what was estimated.

2. Capital Financing Requirement

The Capital Financing Requirement (CFR) measures the council's underlying need to borrow for a capital purpose.

Capital Financing Requirement	2017/18 Estimate £m	2017/18 Estimate (Revised) £m
General Fund Capital Programme	0	0
Embedded Lease (Refuse Contract)	52	52
Total CFR	**52**	**52**

The council's underlying need to borrow for the main capital expenditure activity is nil. The embedded lease element is due to the accounting treatment (required by the Code of Practice) of the underlying assets held by Kier in delivering the refuse contract on behalf of the council.

3. Incremental Impact of Capital Investment Decisions

This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax.

Incremental Impact of Capital Investment Decisions	2017-18 Estimate £	2017-18 Estimate (Revised) £
Increase in Band D Council Tax	0.29	0.72

This represents the impact of the capital investment in terms of potential increase in the Council Tax funding requirement, i.e. the opportunity costs (interest receivable) of not being able to investment these surplus funds.

4. Authorised Limit and Operational Boundary for External Debt

The **Authorised Limit** sets the maximum level of external borrowing on a gross basis (i.e. not net of investments) for the council. It is measured on a daily basis against all external borrowing items on the Balance Sheet (i.e. long and short term borrowing, overdrawn bank balances and long term liabilities).

The **Operational Boundary** links directly to the council's estimates of the CFR and estimates of other cashflow requirements

Authorised Limit for External Debt	2017/18 Approved £'000
Borrowing	2,000
Other Long-term Liabilities	100
Total	**2,100**
Operational Boundary for External Debt	
Borrowing	0
Other Long-term Liabilities	100
Total	**100**

In the unlikely event that the council would be required to borrow within the Authorised Limit and Operational Boundary, it could only be for short term rather than a long term capital investment plan.

5. Summary

The council is maintaining an affordable and sustainable capital programme in the medium term.

The council does not currently have any external debt and has not breached either the operational or authorised limits as set out in the 2017/18 Treasury Strategy.