Finance Sub-Committee – 18 December 2017

Treasury Management Report to 31 October 2017

Purpose of report

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

Attachment(s)

Appendix 1: Prudential Indicators – as at 31 October 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 0.4% between quarter 2 (April – June) and quarter 3 (July to September), which is in line with the estimated growth.

The Euro zone has seen growth within the service sector, showing the strongest pace of expansion since May, as output rose at a faster pace and employment grew the most in a decade.

GDP growth in the US was revised higher to 3.3% for the year, based on a stronger contribution from business investment and a smaller impact from state/government spending.

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) has risen to 2.8% in the year to October 2017, whilst the figure for the month was recorded at 0%. Rising prices for food and, to a lesser extent, recreational goods provided the largest upward contributions to change in the rate between September 2017 and October 2017.

2.2. **Monetary Policy:** The Monetary Policy Committee (MPC) in November took a majority vote of 7-2 to increase the bank rate by 0.25% to 0.5%. It also voted unanimously to maintain the stock of UK government bond purchases (Quantitative Easing programme) at £435bn.

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

Official Bank Rate	Q4 17	Q1 18	Q2 18	Q3 18	Q4 18	Q1 19	Q2 19	Q3 19	Q4 19
Capita	0.50	0.50	0.50	0.75	0.75	0.75	0.75	0.75	0.75

Treasury Management Activity

2.4. During the first half of 2017/18 financial year, the opportunity for the council to invest its surplus cash for periods beyond 3 to 6 months in duration still remains limited. This has mainly been due to the impact of the uncertainty in the Brexit negotiations in the lead up to the UK leaving the EU in March 2019.

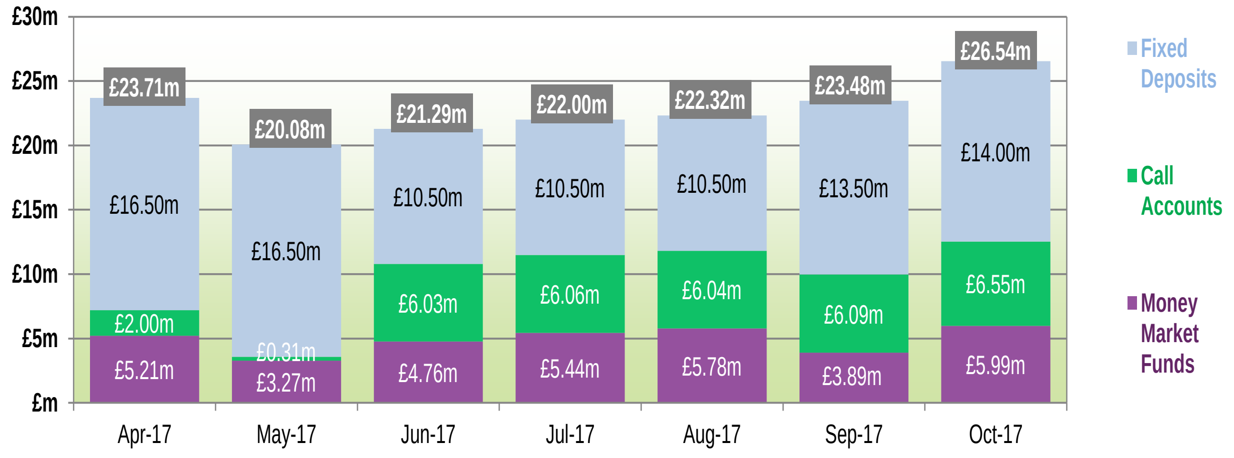
2.5. Investing over shorter durations reduces the counterparty risk the council is exposed to and the potential yield (interest rate) the council can achieve. To mitigate some of the impact of reduced rates, the council opted for fixed term deposits, by investing in a 95 day and a 180 day notice account, which (at present) is yielding 0.46% to 0.65%.

2.6. 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.

2.7. 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.

2.8. The chart below demonstrates the change in investment by type up to 31 October 2017.

Total amount invested October 2017



2.9. 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.

2.10. The level of cash balances held by the council has Increased since April 2017 by £2.83m

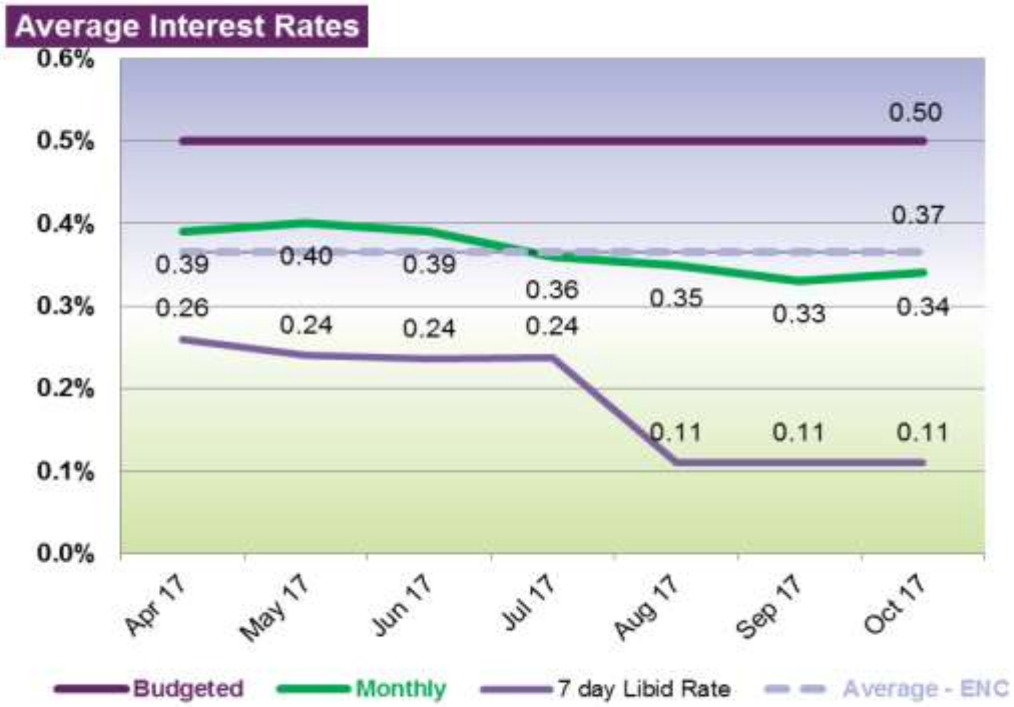
3. Treasury Management Position and Performance

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

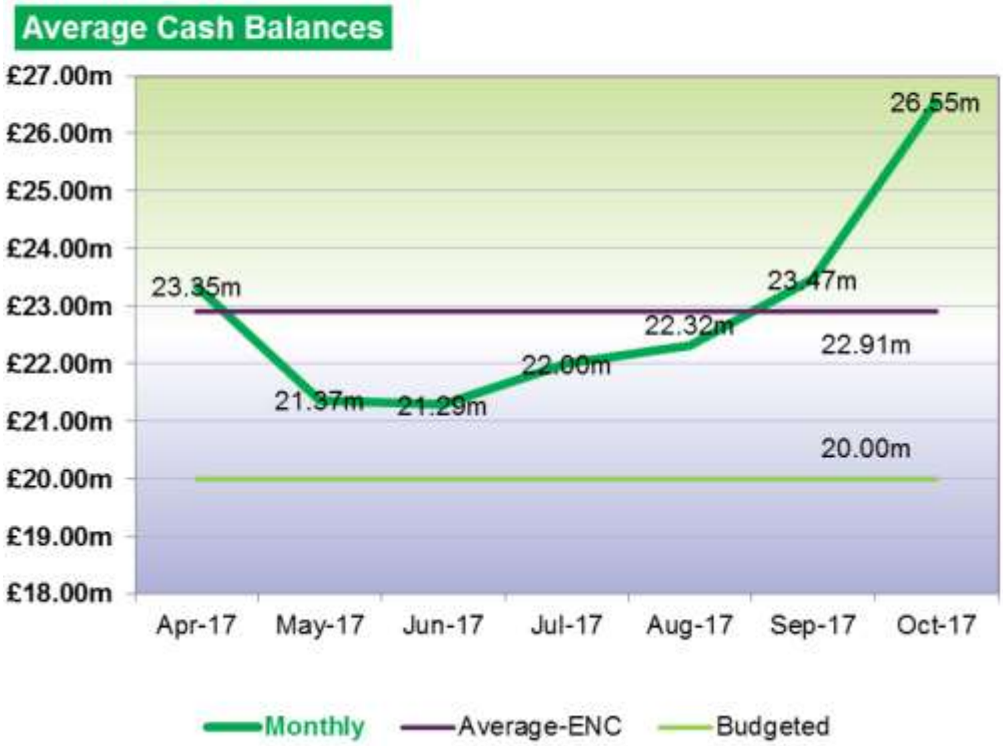
Counterparty / Lender	Amount	Rate %	Maturity Date
Call Accounts			
Santander UK (95 Day notice)	£1,500,000	0.45	
Santander UK (180 Day notice)	£1,500,000	0.55	
Goldman Sach's (180 Day notice)	£3,000,000	0.65	
Barclays Bank Current Account	£556,545	0.05	
Money Market Funds			
Federated Sterling Liquidity Fund (Money Market Fund)	£2,998,565	0.22	
Deutsche Bank Sterling Fund (Money Market Fund)	£2,991,571	0.14	
Fixed Term Deposits			
Thurrock Borough Council	£1,500,000	0.50	27/09/2018
Coventry Building Society	£3,000,000	0.35	11/01/2018
Lloyds Bank	£1,000,000	0.36	19/12/2017
Nationwide Building Society	£3,000,000	0.32	04/01/2018
Plymouth City Council	£3,000,000	0.25	02/01/2018
Salford City Council	£2,500,000	0.46	27/07/2018
	£26,546,680		

3.2. The average return on the council's portfolio at 31st October 2017 is 0.34%. This is 0.23% above the average 7-day London Interbank Bid Rate (LIBID) of 0.11%.

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%. However, interest rates were increased in November from 0.25% to 0.50% and it is expected that we will be able to achieve the expected interest rate by the end of the year. If so, this would increase the average return to around 0.4%. Any increases will be reflected in future reports. The performance to date is shown 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 in October is due to the timing of council tax, business rates receipts and the mid year realignment of housing benefit subsidy.



3.5. For 2017/18, the interest receivable is expected to be below budget by approximately £8k.

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 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.

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

Treasury Management Budget vs. Estimated Outturn				
	Budget	**Estimated Outturn**	**Shortfall**	
	£	**£**	**£**	
Investments	£100,000	£91,858	(£8,142)	Lower interest rates being achieved, partly offset by higher than expected cash balances
Total	**£100,000**	**£91,858**	**(£8,142)**	

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 0.34% 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 Forecast
Capital Expenditure	£1,804,005	£5,948,954
Increase in Band D Council Tax	0.29p	0.66p

5. Markets in Financial Instruments Directive II (MiFID)

5.1. The Markets in Financial Instruments Directive (MiFID) is the framework of European Union (EU) legislation for:

- investment intermediaries that provide services to clients around shares, bonds, units in collective investment schemes and derivatives (collectively known as ‘financial instruments’), and
- the organised trading of financial instruments

5.2. MiFID was applied in the UK from November 2007, but is now being revised to improve the functioning of financial markets in light of the financial crisis and to strengthen investor protection.

5.3. The changes are currently set to take effect from **3 January 2018**, with the new legislation being known as MiFID II — this includes a revised MiFID and a new Markets in Financial Instruments Regulation (MiFIR).

5.4. Where the council trades in shares, bonds or units it will need to elect to be a ‘professional client’ based on qualifying criteria. Otherwise, Local Authorities will be deemed to be a retail client and unable to trade in financial instruments. The qualifying criteria are:

- a portfolio greater than £10m
- at least 10 transactions per quarter within a financial market
- and/or at least one year of experience within the financial sector.

The Authority only needs to meet 2 of the 3 criteria to qualify as a professional client.

5.5. Officers are currently in the process of completing all the forms and questionnaires (where required) to elect the council as a professional client as from 3 January 2018.

6. Equality and Diversity Implications

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

7. Legal Implications

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

8. Risk Management

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

9. Resource and Financial Implications

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

10. Constitutional Implications

10.1. This report does not require any amendment to the Council’s Constitution.

11. Implications for our Customers

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

12. 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

13. Recommendations

13.1. Finance Sub-Committee is recommended to note the Treasury Management performance for period up to 31 October 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: 04/12/2017</td></tr>
<tr><td>CFO</td><td></td><td>MO</td><td></td><td>CX</td><td></td></tr>
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Appendix 1

Prudential Indicators – as at 31 October 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	0.66

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.