Public
Key Decision – No

HUNTINGDONSHIRE DISTRICT COUNCIL

Title/Subject Matter:	Treasury Management Six Month Performance Review
Meeting/Date:	Cabinet – 22nd November 2018
Executive Portfolio:	Strategic Resources: Councillor J A Gray (Executive Councillor for Strategic Resources)
Report by:	Head of Resources
Ward(s) affected:	All Wards

Executive Summary:

Best practice and prescribed treasury management guidance requires Members to be kept up to date in respect of treasury management activity for the first half of the year, including investment and borrowing activity and treasury performance.

The main purpose of the Treasury Management is to;

- Ensure the Council has sufficient cash to meet its day to day obligations.
- Borrow when necessary to fund capital expenditure, including borrowing in anticipation of need when rates are considered to be low.
- Invest surplus funds in a manner that balances low risk of default by the borrower with a fair rate of interest.

The key market Treasury Management issues through the first half of 2018/19 influencing the Council's decision-making were;

- Economic growth forecasts are becoming more pessimistic, and real wage growth is low.
- The Bank of England has kept the Bank Rate at 0.75%, with the expectation that rises will be made slowly, probably in response to inflationary pressures.
- Market rates as a whole are very low in response to the fall in the Bank Rate, reducing the Council's ability to earn a return on investments without increasing the risk of the investments. The Council's average investing rate was 0.97%.
- Whilst there have been a small number of credit rate changes there is still some concern about the stability of some financial institutions.

The Council's response to the key issues was;

- When the Council has surplus funds these will primarily be invested on a short term basis, in liquidity accounts and money market funds.

- Where possible to take a higher return without sacrificing liquidity.

- When borrowing the Council has used the Public Works Loan Board (PWLB), which offers low fixed rate borrowing, based on gilt yields over a long period. The average interest rate paid was 2.75%.

- Where economic conditions are forecast to deteriorate it is vital to monitor financial institutions credit rating, and credit default swap rates (the cost to insure lending).

The Council's Commercial Investment Strategy (CIS)

The Commercial Investment Strategy commenced in 2015/16. Indicators relating to the investments are shown in **Appendix E.**

The returns from the CIS portfolio represent a higher return than those from financial institutions and in addition offer a less risky investment as they are backed by a physical asset.

The yield from the pre-CIS estate is 10.2%. The average yield from the CIS estate is 7.1%. The yield from the pre-CIS estate is higher because the values of these properties are lower (the yield is income divided by the property value).

Until 2017/18 the CIS purchases have been financed from the earmarked CIS Reserve, in October 2017 a £5m loan was taken out to finance Parkway, Fareham. At the start of 2018/19 the balance on this reserve was £3.6m, and as at 30th September 2018 remained at £3.6m.

Recommendation(s):

The Cabinet is recommended to

- Note the treasury management performance for the first 6 months of 2018/19 and to recommend the report to Council for consideration.

1. PURPOSE OF THE REPORT

1.1 The purpose of this report is to update Members on the Council's treasury management activity for the first six months of the year, including investment and borrowing activity and treasury performance.

2. BACKGROUND

2.1 It is regarded as best practice and prescribed treasury management practice, that Members are kept up to date in treasury management activity.

2.2 The Council approved the 2018/19 Treasury Management Strategy at its meeting on 21st February 2018.

2.3 All treasury management activity undertaken during the first half of 2018/19 complied with the CIPFA Code of Practice and relevant legislative provisions.

2.4 The investment strategy is to invest any surplus funds in a manner that balances low risk of default by the borrower with a fair rate of interest. The Council's borrowing strategy permits borrowing for cash flow purposes and funding current and future capital expenditure over whatever periods are in the Council's best interests.

3. ANALYSIS

Economic Review

3.1 An economic review of the year has been provided by our Treasury Management advisors, Arlingclose and is attached with an analysis of the local context implications in **Appendix A**. The main relevance to the Council is

- Economic growth has increased slightly in pace in quarter 2 of 2018.
- Real wage growth is low at only 0.2% per annum.
- Inflation rose to an annual rate of 2.7% in August. This was above the Bank of England forecast.
- The bank rate has risen to 0.75%. As a consequence the Council's borrowing costs will remain low but the opportunities to make significant returns on financial investments remain limited but improving.
- There have been strong market reactions, in particular to the political crisis in Italy, leading to sharp bond yield reductions.

Performance of Council Funds

3.2 The following table summarises the treasury management transactions undertaken during the first 6 months of 2018/19 financial year and the details of the investments and loans held as at 30th September 2018 are shown in detail in **Appendix B**.

	Principal Amount £m	Interest Rate %
Investments		
at 1st April 2018	4.1	1.73
less matured in year	-109.8	
plus arranged in year	+120.2	
at 30th September 2018	14.5	3.86
Average Investments to 30 Sept	**0.99**	**0.87**
Borrowing		
at 1st April 2018	20.69	3.91
less repaid in year	-0.12	
plus arranged in year	+5.00	0.50
at 30th September 2018	25.57	
Average Borrowing to 30 Sept	**1.96**	**2.75**
Note; Interest rates above are as at dated apart from averages, where these are the average for the half year.		

Investments

3.3 The Council's strategy for 2018/19 was based on all investments being managed in-house. The investments were of three types:

- Time deposits, these are deposits with financial institutions that are of a fixed term and mature on an agreed date. In the Council's case usually in 1 to 2 weeks.

- Liquidity (call) accounts, these are accounts held with banks where there is no fixed term and the money can be deposited or withdrawn on the day.

- Money Market Funds, these are funds where investor's deposits are aggregated together and invested across a large range of financial products, giving a high degree of diversification.

3.4 The average rate of interest on all investments was 0.49%, 0.06% above the 7 day LIBID (London Interbank Bid Rate) benchmark rate of 0.43%. This is representative of the slight increase in rates since the bank rate increases in November 2017 (to 0.5%) and August 2018 (to 0.75%)

3.5 When only short-term cash flow investment activity is considered, the rate of interest on investments was 0.51%, which has achieved the 7-day benchmark rate of 0.43%.

Borrowing

3.6 The Council's exposure to interest rate risk at the end of September was:

- £20.57m long term borrowing from the PWLB, at a weighted average rate of 3.47%.

- Short term borrowing at 30th September 2018 was nil.

3.7 The actual net investment interest (after deduction of interest receivable on loans) was £204,454 to 30 September 2018 against a forecast figure of £306,161.60 and the budget figure of £299,000.

3.8 There was short-term borrowing of £5m during 2018/19, in order to meet the Council's cash flow requirements.

The Risk Environment

3.9 The changes to the environment in which investing takes place are detailed in **Appendix C** the main points to note are;

- Bail in legislation requiring investors to contribute to bank losses has replaced government bail outs. If a bank were to become insolvent then investors funds (including Councils), will be used to refinance the bank, in this circumstance the Council would lose a proportion of its investment. To mitigate this risk the Council's funds are invested for short periods, which means that funds can be withdrawn from that institution before it fails.

- Counter-party and credit rating updates; there were only a few credit rating changes, however credit default (a type of loan insurance) rates have risen, but are still at low levels compared to historic averages.

- MIFID2 was implemented in January 2018, The Council will need to continue to demonstrate its officers and members have the necessary treasury skills and experience to meet the professional status set by MiFiD2

- The regulations covering money market funds are being tightened up, so that they must meet strict new criteria and minimum liquidity requirements. This will take effect in January 2019.

Risk Management

3.10 The Council's primary objectives for the management of its investments are to give priority to the **security** and **liquidity** (how quickly cash can be accessed) of its funds before seeking the best rate of **return**.

3.11 The Council manages security by investing short-term with highly-rated banks and building societies, as well as investing with local authorities in the UK which are deemed to be intrinsically safe.

3.12 In addition to this the Council makes significant use of a number of Money Market Funds, where a large numbers of investors' funds, including the Council's, are aggregated and spread across a wide range of investments. The Council is therefore able to access a spread of investments across a number of funds not available if it were to invest on its own.

3.13 In order to manage liquidity the Council invests funds in call accounts or Money Market Funds, which provide instant access to funds.

3.14 The Council's priority has been security and liquidity, over the return on investments, which resulted in investments during 2018/19 generally being of short duration (the majority on call). The result of low interest rates across the market is that the margin gained from the benefit of investing for longer period does not out-weigh the potential costs of failure of the investment.

Compliance with Regulations and Codes

3.15 All the treasury management activity undertaken during the financial year complied with the approved strategy, the CIPFA Code of Practice, and relevant legislation.

3.16 The Code requires the Council to approve both Treasury Management and Prudential Indicators. Those for 2018/19 were approved at the Council meeting on 21st February 2018. **Appendix D** shows the relevant prudential indicators and the actual or forecast for 30th September 2018, the table below is a summary of key indicators. CIPFA issued a consultation in the summer on proposed amendments to be made to the Code of Practice. The Council has responded to consultation giving its views on the proposed changes to the indicators. An emphasis is being placed on the use of local indicators, and the council is already making use of these for its CIS programme.

Prudential Indicators			
	2018/19 Estimate	**2018/19 Forecast**	**Impact on the Council**
Net capital expenditure	£7.4m	£7.1m	The forecast spend is higher than budget due to an estimated overspend on DFGs of £0.6m
Expenditure on interest and MRP (Minimum Revenue Provision)	13.0%	11.1%	As a result of expenditure rephasing and underspends in 2017/18 the MRP is lower for 2018/19.
Impact of schemes on the Council	£2.61	(£2.02)	The decrease in cost is as a result of reductions in the need to borrow (interest) and MRP.
Capital Financing Requirement (CFR)	£43.8m	£44.6m	The CFR has edged higher due to the forecast overspend as a result of DFG demand.
	31/03/18	**30/09/18**	
Long-term borrowing total	£20.91m	£20.57m	No new debt has been taken out in the period 01/04/28 to 30/09/18
Treasury Management Indicators			
	2018/19 Limit	**2018/19 Actual**	
Authorised Limit for debt	£123.0m	£20.57m	The Council's debt has decreased as no new loans have been taken out so far in 2018/19, and principal repayments have been made to reduce the overall balance.
Operational boundary for debt	£118.0m	£20.57m	

Upper limit on Fixed interest rate exposure Variable interest rate exposure	 £80.0m £35.0m	 £24.3m £24.4m	Investments made for less than 1 year have been classified as variable.
Borrowing repayment profile (10 years)	20%-100%	80.1%	The loan repayment profile has remained the same.
Investments longer than 364 days	£68.2m	£4.00m	Only includes Treasury investments not service based loans. Treasury investment are short-term or instant access investments.

Commercial Investment Strategy (CIS)

3.17 The CIS business plan was approved in December 2015. The implementation of the CIS is a key part of the Council's strategy to generate additional income to assist in closing the Council's forecast gap in the revenue budget.

3.18 Opportunities for investments are being sought and evaluated on an on-going basis. During the first half of 2018/19, 38 potential CIS purchases have been evaluated. The results of this analysis are shown in table 7 in Appendix E giving if rejected, the reason for rejection.

3.19 The yields from the CIS assets are shown in Appendix E, as well as the yield from the existing commercial estate. The CIS Business Plan targeted returns as a minimum for land and building investment of between 6% and 9%. This has been achieved and exceeded in the case of Stonehill, Huntingdon. The returns from these investments are key to closing the Council's revenue funding gap, and represent a significantly higher return than can be achieved on investments with financial institutions.

3.20 A number of the indicators shown in **Appendix E** will not be relevant until the CIS Reserve is fully applied and borrowing is required to continue to purchase assets. When borrowing commences, these indicators will be calculated.

4. COMMENTS OF OVERVIEW AND SCRUTINY

4.1 This report is to be considered at the meeting held on the 6th of November 2018.

5. RISKS

5.1 The risks arising from treasury management activities are highlighted in the report and are measured by reference to the prudential indicators in **Appendix D**.

6. WHAT ACTIONS WILL BE TAKEN

6.1 Treasury management activities will continue to be monitored, in order to mitigate security and liquidity risks.

7. LINK TO THE CORPORATE PLAN, STRATEGIC PRIORITIES AND / OR CORPORATE OBJECTIVES

7.1 Treasury management activity is a corporate function of the Council and supports the achievement of the Councils three corporate priorities; consequently it is a key element in the budget setting and management process.

7.2 In addition, the Council's Treasury function directly contributed to the "Develop stronger and more resilient communities to enable people to help themselves" (Corporate Plan 2018-2022). As a result loan finance was provided by the council to support external partners;

- Places for People – Eden Place Care Facility
- Huntingdon Gymnastic Club – Huntingdon Gym
- Cambridge Regional College – Huntingdon Campus Building

8. LEGAL IMPLICATIONS

8.1 No direct, legal implications arise out of this report.

9. RESOURCE IMPLICATIONS

9.1 The resource implications relating to the net interested due to the council is explained in paragraph 3.7.

10. REASONS FOR THE RECOMMENDED DECISIONS

10.1 The treasury management activity continues to be monitored, to ensure that risks arising are mitigated.

11. LIST OF APPENDICES INCLUDED

Appendix A – Economic review (Source: Arlingclose)
Appendix B – Borrowing and Investments as at 30th September 2018
Appendix C – Risk Environment
Appendix D – Prudential Indicators
Appendix E – Commercial Investment Strategy Indicators
Appendix F – Glossary

BACKGROUND PAPERS
Investment Spreadsheets held in Resources
CIPFA Treasury Management Code of Practice

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