# TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY – MID YEAR REVIEW REPORT 2017-18

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| Cabinet | **16 January 2018** |
| Report Author | **Tim Willis, Director of Corporate Resources & Section 151 Officer** |
| Portfolio Holder | **Councillor John Townend, Portfolio Holder for Financial Services and Estates** |
| Status | **For Decision** |
| Classification: | **Unrestricted** |
| Key Decision | **No** |
| Previously Considered by | **Governance and Audit Committee – 6 Dec 2017** |


**Executive Summary:**

This report summarises treasury management activity and prudential/ treasury indicators for the first half of 2017-18.


**Recommendation(s):**

That Cabinet:

- Approves this report and the prudential and treasury indicators that are shown.
- Recommends this report to Council.

| **CORPORATE IMPLICATIONS** | |
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| **Financial and Value for Money** | The financial implications are highlighted in this report. |
| **Legal** | Section 151 of the 1972 Local Government Act requires a suitably qualified named officer to keep control of the Council's finances. For this Council, this is the Director of Corporate Resources, Tim Willis, and this report is helping to carry out that function. |
| **Corporate** | Failure to undertake this process will impact on the Council's compliance with the Treasury Management Code of Practice. |
| **Equalities Act 2010 & Public Sector Equality Duty** | There are no equity and equalities implications arising directly from this report, but the Council needs to retain a strong focus and understanding on issues of diversity amongst the local community and ensure service delivery matches these.<br><br>It is important to be aware of the Council's responsibility under the |

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| | Public Sector Equality Duty (PSED) and show evidence that due consideration had been given to the equalities impact that may be brought upon communities by the decisions made by Council. |

| **CORPORATE PRIORITIES (tick those relevant)✓** | |
|---|---|
| A clean and welcoming Environment | |
| Promoting inward investment and job creation | |
| Supporting neighbourhoods | |

| **CORPORATE VALUES (tick those relevant)✓** | |
|---|---|
| Delivering value for money | ✓ |
| Supporting the Workforce | |
| Promoting open communications | |

**1.0 Introduction and Background**

1.1 The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

1.2 The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

1.3 Accordingly treasury management is defined as:

"The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

1.4 The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2011) was adopted by this Council on 24 April 2014.

1.5 The primary requirements of the Code are as follows:

- Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
- Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
- Receipt by the full Council of an annual Treasury Management Strategy Statement (including the Annual Investment Strategy and Minimum Revenue Provision Policy) for the year ahead, a **Mid-year Review Report** and an Annual Report (stewardship report) covering activities during the previous year.

- Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
- Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is the Governance and Audit Committee.

1.6 This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- An economic update for the first half of the 2017-18 financial year;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Council's capital expenditure (prudential indicators);
- A review of the Council's investment portfolio for 2017/18;
- A review of the Council's borrowing strategy for 2017/18;
- A review of any debt rescheduling undertaken during 2017/18;
- A review of compliance with Treasury and Prudential Limits for 2017/18.

1.7 There have not been any key changes to the Treasury and Capital Strategies during the first half of 2017-18.

## 2.0 Capita's Interest rate forecasts (issued by Capita on 3 October 2017)

2.1 The Council's treasury advisor, Capita Asset Services (Capita), has provided the following forecast:

| | Dec-17 | Mar-18 | Jun-18 | Sep-18 | Dec-18 | Mar-19 | Jun-19 | Sep-19 | Dec-19 | Mar-20 |
|---|---|---|---|---|---|---|---|---|---|---|
| Bank rate | 0.25% | 0.25% | 0.25% | 0.25% | 0.25% | 0.25% | 0.50% | 0.50% | 0.75% | 0.75% |
| 5yr PWLB rate | 1.50% | 1.60% | 1.70% | 1.70% | 1.80% | 1.80% | 1.90% | 1.90% | 2.00% | 2.00% |
| 10yr PWLB rate | 2.20% | 2.30% | 2.30% | 2.40% | 2.40% | 2.50% | 2.50% | 2.60% | 2.60% | 2.70% |
| 25yr PWLB rate | 2.90% | 2.90% | 3.00% | 3.00% | 3.10% | 3.10% | 3.20% | 3.20% | 3.30% | 3.30% |
| 50yr PWLB rate | 2.70% | 2.70% | 2.80% | 2.80% | 2.90% | 2.90% | 3.00% | 3.00% | 3.10% | 3.10% |

2.2 Capita Asset Services undertook its last review of interest rate forecasts on 9 August after the quarterly Bank of England Inflation Report. There was no change in Monetary Policy Committee (MPC) policy at that meeting. However, the MPC meeting of 14 September revealed a sharp change in sentiment whereby a majority of MPC members said they would be voting for an increase in Bank Rate "over the coming months". It is therefore possible that there will be an increase to 0.5% at the November MPC meeting. If that happens, the question will then be as to whether the MPC will stop at just withdrawing the emergency Bank Rate cut of 0.25% in August 2016, after the result of the EU withdrawal referendum, or whether they will embark on a series of further increases in Bank Rate during 2018.

2.3 The overall balance of risks to economic recovery in the UK is currently to the downside but huge variables over the coming few years include just what final form Brexit will take, when finally agreed with the EU, and when.

2.4 Downside risks to current forecasts for UK gilt yields and Public Works Loan Board (PWLB) rates currently include:

- UK economic growth and increases in inflation are weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU and US.
- Geopolitical risks in Europe, the Middle East and Asia, which could lead to increasing safe haven flows.
- A resurgence of the Eurozone sovereign debt crisis.
- Weak capitalisation of some European banks.
- Monetary policy action failing to stimulate sustainable growth and to get inflation up consistently to around monetary policy target levels.

2.5 The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -

- The pace and timing of increases in the Federal Reserve (Fed) Funds Rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.
- UK inflation returning to significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

## 3.0 Treasury Management Strategy Statement and Annual Investment Strategy Update

3.1 The Treasury Management Strategy Statement (TMSS) for 2017-18, which includes the Annual Investment Strategy, was approved by the Council on 9 February 2017. There are no policy changes to the TMSS; the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

## 4.0 The Council's Capital Position (Prudential Indicators)

4.1 This part of the report is structured to update:

- The Council's capital expenditure plans;
- How these plans are being financed;
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity.

### 4.2 Prudential Indicator for Capital Expenditure

This table shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the Budget.

The revised estimate includes carry-forward from the previous year of £6.456m General Fund and £16.276m HRA.

| Capital Expenditure | 2017-18 Original Estimate £m | Current Position – Actual at 30/09/17 £m | 2017-18 Revised Estimate £m |
|---|---|---|---|
| General Fund | 8.478 | 2.444 | 14.768 |
| HRA | 3.855 | 1.756 | 21.882 |
| **Total** | **12.333** | **4.200** | **36.650** |

**4.3**

**Changes to the Financing of the Capital Programme**

The table below draws together the main strategy elements of the capital expenditure plans (above), highlighting the original supported and unsupported elements of the capital programme, and the expected financing arrangements of this capital expenditure. The borrowing element of the table increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

| Capital Expenditure | 2017-18 Original Estimate £m Total | Current Position – Actual at 30/9/17 £m | 2017-18 Revised Estimate £m GF | 2017-18 Revised Estimate £m HRA | 2017-18 Revised Estimate £m Total |
|---|---|---|---|---|---|
| **Total spend** | 12.333 | 4.200 | 14.768 | 21.882 | 36.650 |
| Financed by: | | | | | |
| Capital receipts | 0.582 | | 3.224 | 2.444 | 5.668 |
| Capital grants | 3.421 | | 5.554 | 2.233 | 7.787 |
| Reserves | 3.705 | | 0.212 | 9.244 | 9.456 |
| Revenue | 0.350 | | 0.296 | 1.056 | 1.352 |
| **Total financing** | 8.058 | | 9.286 | 14.977 | 24.263 |
| **Borrowing need** | **4.275** | | **5.482** | **6.905** | **12.387** |

**4.4 Changes to the Prudential Indicators for the Capital Financing Requirement, External Debt and the Operational Boundary**

The table shows the CFR, which is the underlying external need to incur borrowing for a capital purpose. It also shows the expected debt position over the period, which is termed the Operational Boundary.

**Prudential Indicator – Capital Financing Requirement**

We are on target to achieve the forecast Capital Financing Requirement.

**Prudential Indicator – the Operational Boundary for external debt**

| | 2017-18 Original Estimate £m | Current Position – Actual at 30/9/17 £m | 2017-18 Revised Estimate £m |
|---|---|---|---|
| **Prudential Indicator – Capital Financing Requirement** | | | |
| CFR – non housing | 32.237 | | 30.963 |
| CFR – housing | 27.332 | | 27.283 |
| Total CFR | 59.569 | | 58.246 |
| **Net movement in CFR** | **12.486** | | **11.163** |
| | | | |
| **Prudential Indicator – the Operational Boundary for external debt** | | | |
| Borrowing | 50.000 | 31.401 | 50.000 |
| Other long term liabilities* | 12.000 | 3.094 | 12.000 |
| **Total debt** | **62.000** | **34.495** | **62.000** |

** On balance sheet PFI schemes and finance leases etc (including the leisure centre deferred credit). Excludes the amount owed to KCC for the Westwood spine road construction as classified as a current liability.*

## 4.5 Limits to Borrowing Activity

The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, borrowing will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2017-18 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

| | 2017-18 Original Estimate £m | Current Position – Actual at 30/09/17 £m | 2017-18 Revised Estimate £m |
|---|---|---|---|
| Gross borrowing | 43.799 | 31.401 | 31.086 |
| Plus other long term liabilities* | 2.975 | 3.094 | 2.630 |
| Total gross borrowing | 46.774 | 34.495 | 34.010 |
| CFR (year end position) | 59.569 | | 58.246 |

** On balance sheet PFI schemes and finance leases etc (including the leisure centre deferred credit). Excludes the amount owed to KCC for the Westwood spine road construction as classified as a current liability.*

The Section 151 Officer reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

| Authorised limit for external debt | 2017-18 Original Indicator £m | Current Position – Actual at 30/09/17 £m | 2017-18 Revised Indicator £m |
|---|---|---|---|
| Borrowing | 55.000 | 31.401 | 55.000 |
| Other long term liabilities* | 15.000 | 3.094 | 15.000 |
| Total | 70.000 | 34.495 | 70.000 |

** On balance sheet PFI schemes and finance leases etc (including the leisure centre deferred credit). Excludes the amount owed to KCC for the Westwood spine road construction as classified as a current liability.*

## 5.0 Investment Portfolio 2017/18

5.1 In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite. As shown by forecasts in Section 2, it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low and in line with the current 0.25% Bank Rate. The continuing potential for a re-emergence of a Eurozone sovereign debt crisis, and its impact on banks, prompts a low risk and short term strategy. Given this risk environment and the fact that increases in Bank Rate are likely to be gradual and unlikely to return to the levels seen in previous decades, investment returns are likely to remain low.

5.2 The Council held £45.108m of investments as at 30 September 2017 (£37.988m at 31 March 2017) and the investment portfolio yield for the first six months of the year is 0.35% against a benchmark (average 7-day LIBID rate) of 0.11%. The constituent investments are:

| Sector | Country | Up to 1 year £m | 1 year – 370 days £m | Total £m |
|---|---|---|---|---|
| **Banks** | UK | 13.275 | 0.000 | 13.275 |
| **Banks** | Sweden | 4.504 | 0.000 | 4.504 |
| **Money Market Funds** | UK | 27.329 | 0.000 | 27.329 |
| **Total** | | **45.108** | **0.000** | **45.108** |

5.3 The Section 151 Officer confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2017/18.

5.4 The Council's budgeted investment return for 2017/18 is £0.033m and performance for the first half of the financial year is above budget at £0.079m.

**5.5 Investment Risk Benchmarking**

Investment risk benchmarks were set in the 2017/18 Treasury Management Strategy Statement (TMSS) for security, liquidity and yield. The mid-year position against these benchmarks is given below.

**5.5.1 Security**

The Council's maximum security risk benchmark for the current portfolio, when compared to historic default tables, is:

- 0.05% historic risk of default when compared to the whole portfolio.

The security benchmark for each individual period is:

| | 370 days | 2 years | 3 years | 4 years | 5 years |
|---|---|---|---|---|---|
| **Maximum** | **0.05%** | **0.00%** | **0.00%** | **0.00%** | **0.00%** |

Note: This benchmark is an average risk of default measure, and would not constitute an expectation of loss against a particular investment.

The Section 151 Officer can report that the investment portfolio was maintained within this overall benchmark for the first half of this financial year.

**5.5.2 Liquidity**

In respect of this area the Council seeks to maintain:

- Bank overdraft - £0.5m
- Liquid short term deposits of at least £10m available with a week's notice.
- Weighted Average Life benchmark is expected to be 0.5 years, with a maximum of 1.0 year.

The Section 151 Officer can report that liquidity arrangements were adequate for the first half of this financial year.

This authority does not currently place investments for more than 370 days due to the credit, security and counterparty risks of placing such investments.

**5.5.3 Yield**

Local measures of yield benchmarks are:

- Investments – Internal returns above the 7 day LIBID rate

The Section 151 Officer can report that the yield on deposits for the first half of the financial year is 0.35% against a benchmark (average 7-day LIBID rate) of 0.11%.

## 5.6 Investment Counterparty criteria

The current investment counterparty criteria selection approved in the revised TMSS is meeting the requirement of the treasury management function.

## 6.0 Borrowing

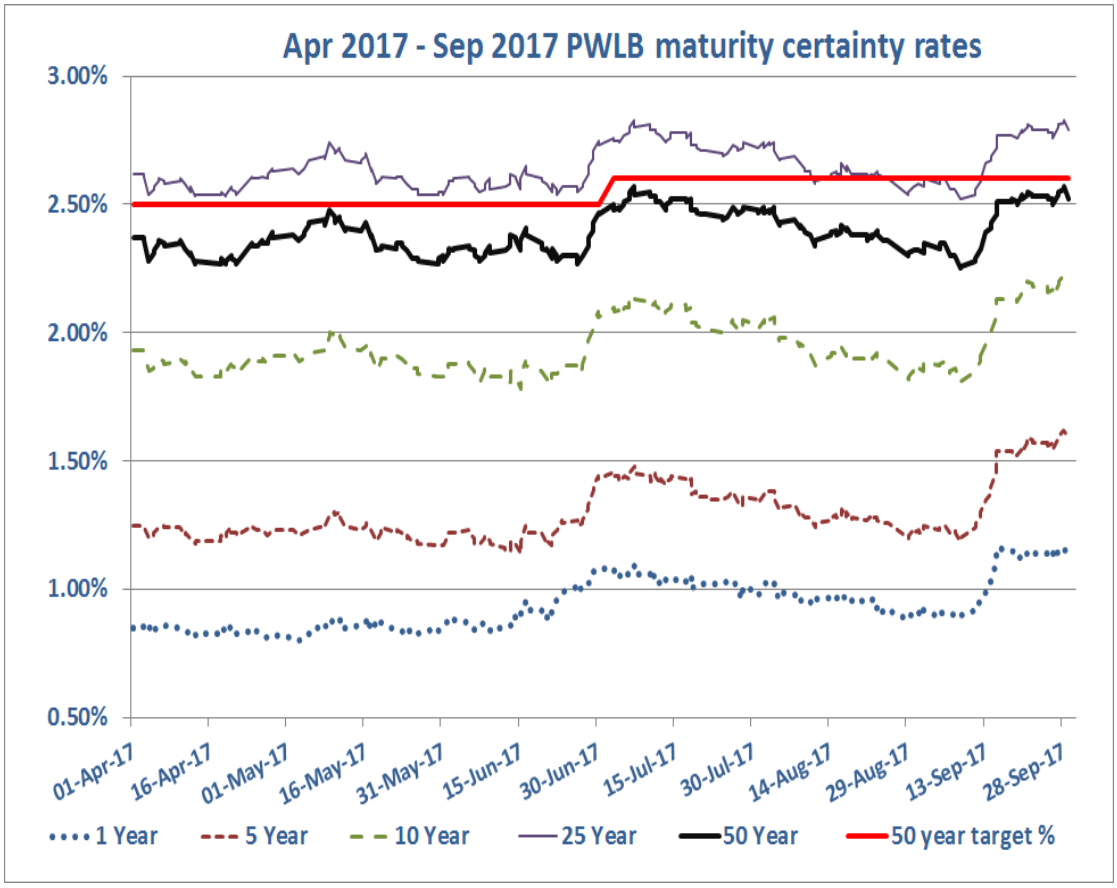
6.1 The Council's capital financing requirement (CFR) original estimate for 2017-18 is £59.569m. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions. The Council has borrowings of £31.401m (table 4.5) and has utilised an estimated £28.168m of cash flow funds in lieu of borrowing. This is a prudent and cost effective approach in the current economic climate but will require ongoing monitoring in the event that upside risk to gilt yields prevails.

6.2 Due to the overall financial position and the underlying need to borrow for capital purposes (the capital financing requirement – CFR), new external borrowing of £0.043m was undertaken during the first half of the financial year, for five years at zero interest rate repayable by equal instalments of principal over the term of the loan.

6.3 Borrowing may be undertaken during the second half of this financial year and options will be reviewed in due course in line with market conditions.

6.4 The graph and table below show the movement in PWLB certainty rates for the first six months of the year to 30 September 2017.

**6.5 PWLB certainty rates, half year ended 30th September 2017**




| | 1 Year | 5 Year | 10 Year | 25 Year | 50 Year |
|---|---|---|---|---|---|
| Low | 0.8 | 1.14 | 1.78 | 2.52 | 2.25 |
| Date | 03/05/2017 | 15/06/2017 | 15/06/2017 | 08/09/2017 | 08/09/2017 |
| High | 1.16 | 1.62 | 2.22 | 2.83 | 2.57 |
| Date | 15/09/2017 | 28/09/2017 | 28/09/2017 | 07/07/2017 | 07/07/2017 |
| Average | 0.9408 | 1.2981 | 1.9470 | 2.6475 | 2.3917 |

6.7 Debt rescheduling opportunities have been very limited in the current economic climate given the consequent structure of interest rates, and following the increase in the margin added to gilt yields which has impacted PWLB new borrowing rates since October 2010. No debt rescheduling has therefore been undertaken to date in the current financial year. The Council is currently under-borrowed to address investment counterparty risk and the differential between borrowing and investment interest rates. This position is carefully monitored.

6.8 The Council's budgeted debt interest payable for 2017-18 is £1.666m and performance for the first half of the financial year is below budget at £0.583m.

## 7.0 Treasury Management Indicators

### 7.1 Ratio of financing costs to net revenue stream

This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

| % | 2017-18 Original Indicator | 2017-18 Revised Indicator |
|---|---|---|
| Non-HRA | 9.1% | 7.3% |
| HRA | 7.6% | 6.0% |

**7.2** **Upper Limits on Variable Rate Exposure** – This identifies a maximum limit for variable interest rates based upon the debt position net of investments.

**Upper Limits on Fixed Rate Exposure** – Similar to the previous indicator, this covers a maximum limit on fixed interest rates.

Both of these are shown in the below table:

| | 2017-18 Original Indicator £m | Current Position – Actual at 30/09/17 £m | 2017-18 Revised Indicator £m |
|---|---|---|---|
| **Upper limits on fixed interest rates** | | | |
| Debt only | 70.000 | 31.401 | 70.000 |
| Investments only | 45.000 | 17.775 | 45.000 |
| **Upper limits on variable interest rates** | | | |
| Debt only | 70.000 | 0.000 | 70.000 |
| Investments only | 50.000 | 27.333 | 50.000 |

### 7.3 Maturity Structures of Borrowing

These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing.

| | 2017-18 Original Upper Limit | Current Position – Actual at 30/09/17 | 2017-18 Revised Upper Limit |
|---|---|---|---|
| **Maturity structure of fixed rate borrowing** | | | |
| Under 12 months | 50% | 16% | 50% |
| 1 year to under 2 years | 50% | 5% | 50% |
| 2 years to under 5 years | 50% | 29% | 50% |
| 5 years to under 10 years | 55% | 10% | 55% |
| 10 years to under 20 years | 50% | 21% | 50% |
| 20 years to under 30 years | 50% | 10% | 50% |
| 30 years to under 40 years | 50% | 6% | 50% |
| 40 years to under 50 years | 50% | 3% | 50% |
| 50 years and above | 50% | 0% | 50% |

The current position shows the actual percentage of fixed rate debt the authority has within each maturity span. None of the upper limits have been breached.

## 8.0 Revised CIPFA Codes and MIFID II

### 8.1 Revised CIPFA Codes

The Chartered Institute of Public Finance and Accountancy (CIPFA) has been conducting an exercise to consult local authorities on revising the Treasury Management Code and Cross Sectoral Guidance Notes, and the Prudential Code. CIPFA is aiming to issue the revised codes during November.

A particular focus of this exercise is how to deal with local authority investments which are not treasury type investments e.g. by investing in purchasing property in order to generate income for the authority at a much higher level than can be attained by treasury investments. One recommendation is that local authorities should produce a new report to members to give a high level summary of the overall capital strategy and to enable members to see how the cash resources of the authority have been apportioned between treasury and non-treasury investments. Officers are monitoring developments and will report to members when the new codes have been agreed and issued and on the likely impact on this authority.

### 8.2 MIFID II

The EU has now set a deadline of 3 January 2018 for the introduction of regulations under MIFID II. These regulations will govern the relationship that financial institutions conducting lending and borrowing transactions will have with local authorities from that date. This will have little effect on this authority apart from having to fill in forms sent by each institution dealing with this authority and for each type of investment instrument we use apart from our cash deposits with banks and building societies.

## 9.0 Options

9.1 The recommended option (to ensure regulatory compliance as set out in section 1 of this report) is that Cabinet:

- Approves this report and the prudential and treasury indicators that are shown.
- Recommends this report to Council.

9.2 Alternatively, Cabinet may decide not to do this and advise the reason(s) why.

## 10.0 Next Steps

10.1 This report is to go to Council for approval on 8 February 2018.

## 11.0 Disclaimer

11.1 This report (including annexes) is a technical document focussing on public sector investments and borrowings and, as such, readers should not use the information contained within the report to inform personal investment or borrowing decisions. Neither Thanet District Council nor any of its officers or employees makes any representation or warranty, express or implied, as to the accuracy or completeness of the information contained herein (such information being subject to change without notice) and shall not be in any way responsible or liable for the contents hereof and no reliance should be placed on the accuracy, fairness or completeness of the information contained in this document. Any opinions, forecasts or estimates herein constitute a judgement and there can be no assurance that they will be consistent with future results or events. No person accepts any liability whatsoever for any loss howsoever arising from any use of this document or its contents or otherwise in connection therewith.

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| Contact Officer: | Tim Willis, Director of Corporate Resources & Section 151 Officer, extn 57009 |
| Reporting to: | Madeline Homer, Chief Executive |

**Annex List**

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| Annex 1 | Economic Update and Debt Maturity |
| Annex 2 | Guidance on the Treasury Management Strategy Statement and Annual Investment Strategy – Mid Year Review Report 2017/18 |

**Corporate Consultation Undertaken**

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| Finance | Ramesh Prashar, Head of Financial Services |
| Legal | Tim Howes, Director of Corporate Governance & Monitoring Officer |