Gravesham Borough Council

Report to:	Finance and Audit Committee
Date:	12 June 2018
Reporting officer:	Director (Corporate Services)
Subject:	Annual Treasury Management Review 2017-18

Purpose and summary of report:

To report on treasury management acitivity during 2017-18 in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA's) revised code on Treasury Management 2009.

Recommendations:

1. The Finance and Audit Committee note the contents of this report.

1. INTRODUCTION

1.1 The Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2017-18 in line with the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

1.2 In accordance with reporting requirements for each financial year, Full Council will have received the following reports for 2017-18:

- an annual treasury strategy in advance of the year (Council 21 February 2017)
- a mid-year (minimum) treasury update report (Council 5 December 2017)
- an annual review following the end of the year describing the activity compared to the strategy (this report, which will be received by Council on 26 June 2018 through consideration of the Minutes of this meeting of the Finance & Audit Committee).

1.3 The regulatory environment places responsibility on Members for the review and scrutiny of treasury management policy and activities. This report is, therefore, important in that respect as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by Members.

1.4 The report also provides confirmation that the Council has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Finance and Audit Committee before they were reported to the Full Council.

2. THE ECONOMY AND INTEREST RATES

2.1 There was a major shift during 2017 in the expectations of financial markets in terms of when the UK Bank Rate would start to rise. After the UK economy experienced strong growth in the second half of 2016, growth in the first half of 2017 was more disappointing, being the lowest level of growth for the first half of any year since 2012. The main reason for this was the sharp increase in inflation caused by the devaluation of sterling following the EU referendum, feeding increases into the cost of imports into the economy. This caused a reduction in consumer disposable income and spending power as inflation exceeded average wage increases. Consequently the services sector of the economy (which accounts for 75% of GDP) saw weak growth as consumers responded by cutting back on their expenditure. Growth did, however, pick up modestly in the second half of 2017 with market expectations rising significantly that the Monetary Policy Committee (MPC) would begin its programme of Bank Rate increases. The minutes of the MPC meeting of 14 September indicated that the MPC would be likely to raise the UK Bank Rate very soon and at the of meeting of the MPC on 2 November the Bank Rate was increased from 0.25% to 0.50%. Following the MPC meeting of 8 February, the Committee issued warnings of a more imminent and faster pace of increases in the Bank Rate than had been previously expected. This led to investment rates from 3 to 12 months increasing sharply during the spring quarter.

2.2 In line with the above, there were corresponding increases in PWLB borrowing rates with the shorter term rates increasing more sharply than longer term rates.

2.3 The UK landmark event of the year - the General Election held on 8 June 2017 - had relatively little impact on financial markets.

3. OVERALL TREASURY POSITION

3.1 The Council's treasury position at the beginning and the end of 2017-18 was as follows:

	31 March 2017 Principal £m	Rate/ Return	31 March 2018 Principal £m	Rate/ Return	Average Life
Total Debt	**£101.677**	3.112%	**£98.083**	3.168%	9.90 years
Capital Financing Requirement (CFR)	£112.544	-	£108.832	-	-
Over/ (Under) borrowing	(£10.867)	-	(£10.749)	-	-
Total Investments	**£33.474**	**-**	**£31.320**	**-**	**-**
Internally Managed Investments	£23.490	0.575%	£11.019	0.448%	205 days*
Property Funds	£9.984	-	£10.301	4.13%	-
Multi-Asset Funds	£0	-	£10,000	5.78%	-
Net Debt (Total Debt minus Total Investments)	£68.203	-	£66.763	-	-

*This relates to fixed term investments and certificates of deposits, Money market fund transactions are excluded from the calculation

4. THE STRATEGY FOR 2017-18

4.1 The expectation for interest rates within the treasury management strategy for 2017-18 anticipated that the UK Bank Rate would not start rising from 0.25% until quarter 2 2019 and then only increase once more before 31.3.20. There would also be gradual rises in medium and longer term fixed borrowing rates during 2017-18 and the two subsequent financial years. Variable or short-term rates were expected to be the cheaper form of borrowing over the period. Continued uncertainty in the aftermath of the 2008 financial crisis would promote a cautious approach, whereby investments would continue to be dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

4.2 In this scenario the treasury strategy was to postpone borrowing to avoid the cost of holding higher levels of investments and to reduce counterparty risk.

4.3 During 2017-18, longer term PWLB rates were volatile but with little overall direction whereas shorter term PWLB rates were on a rising trend during the second half of the year.

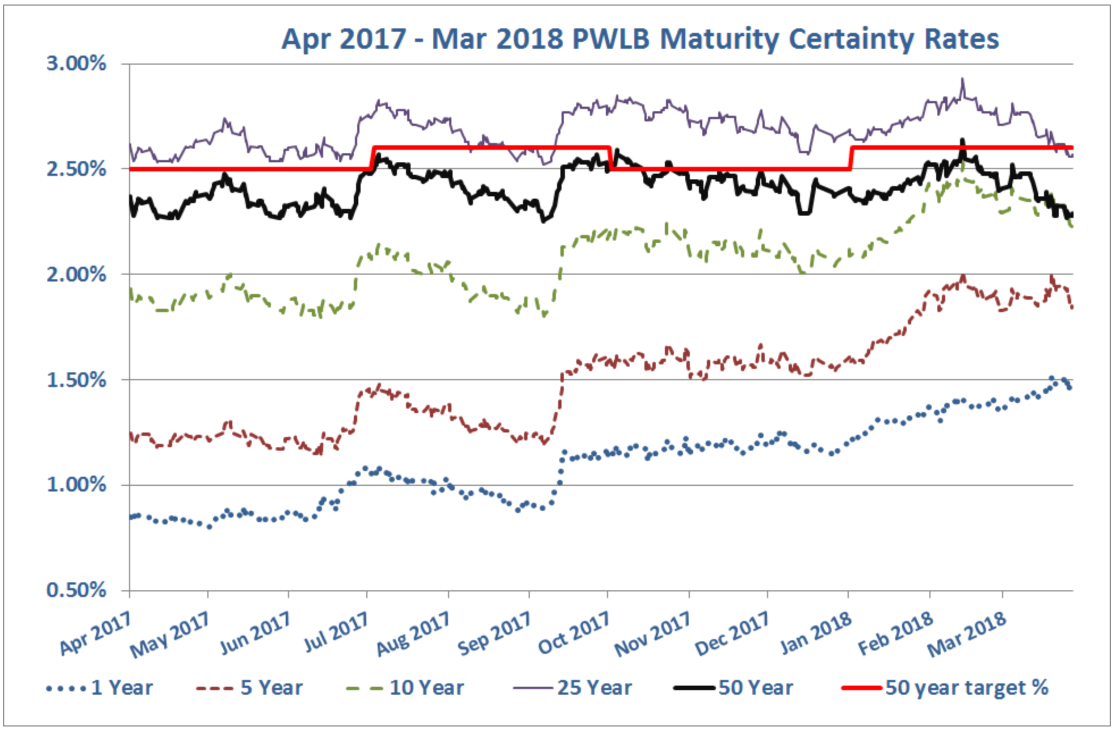
5. THE BORROWING REQUIREMENT AND DEBT

5.1 The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).

	31 March 2017 Actual	31 March 2018 Revised Estimates	31 March 2018 Actual
CFR General Fund (£m)	£20.375	£29.487	£20.167
CFR HRA (£m)	£92.169	£88.665	£88.665
Total CFR (£m)	£112.544	£118.152	£108.832

6. BORROWING RATES IN 2017-18

6.1 As depicted in the graph and table below, PWLB rates fell from April to June and then gained fresh downward impetus after the referendum and Bank Rate cut before staging a partial recovery through to December and then falling slightly through to the end of March.



7. BORROWING OUTTURN FOR 2017-18

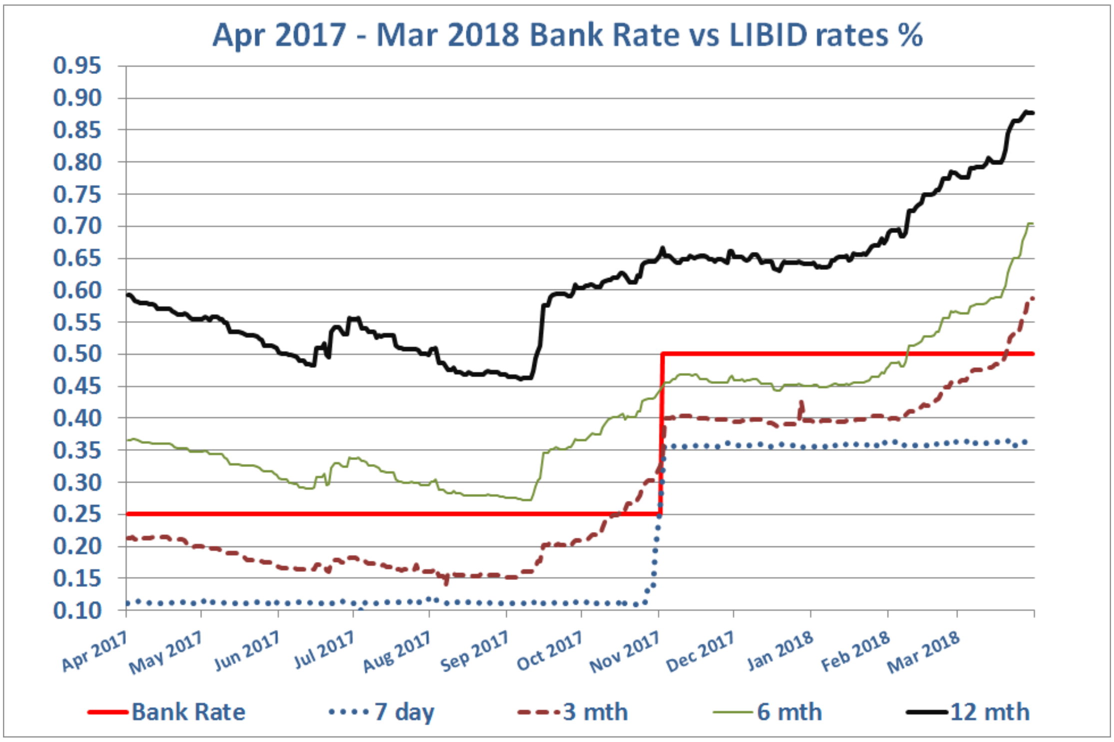
7.1 No borrowing was undertaken during 2017-18.

7.2 No rescheduling of debts was carried out during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

7.3 On 26 March 2018, a further loan the Council had taken on as a result of HRA self-financing matured. Loan principal totalling £3,504,000 was repaid. The Council has made a voluntary contribution of Minimum Revenue Provision (MRP) equal to the loan principal in order to reduce the CFR accordingly.

8. INVESTMENT RATES IN 2017-18

8.1 Investment rates for 3 months and longer were seen to be on a rising trend during the second half of the year (with the expectation of a rise in the UK Bank Rate). The Bank Rate was duly raised from 0.25% to 0.50% on 2 November 2017 and remained at that level for the rest of the year. Further increases are expected over the next few years.



- London Interbank Bid Rate (LIBID) is the average interest rate which major London banks borrow Eurocurrency deposits from other banks

9. Investment Outturn for 2017-18

9.1 **Investments held by the Council** – the Council maintained an average balance of £29,784,887 of internally managed funds during the year. The internally managed funds earned an average rate of return of 0.4481%. The 3 month LIBID rate which is used as the most appropriate comparative performance indicator was 0.2861%. Despite the continued low investment yields offered by financial markets, the average rate of return exceeded by 0.162%.

9.2 **Property Funds** – As at 31 March 2018 the Council achieved an average income rate of return on its Lothbury investments of 4.02%, achieved an average rate of return of 5.13% on its CCLA investments and in respect of its Hermes investments a 3.72% average return was achieved. Across all three funds this represented an average return of 4.13%.

9.3 In addition to the income received from each fund, there has also been capital growth of 6.47% across the funds since the initial deposits were placed. The capital growth on Lothbury has been 6.08%, Hermes has seen growth of 9.84% and CCLA has capital growth of 2.29%.

9.4 **Multi-Asset Funds** – A report on alternative treasury management investment options was presented to the Finance and Audit Committee on 12 September 2017 setting out proposals to progress the use of Multi-Asset Funds (also known as Diversified Income Funds). Following subsequent approval of this by Full Council in October 2017, the authority's Treasury Management Consultants (Link Asset Services) were engaged to assist Officers with the identification and selection of suitable funds. Four companies were invited to give presentations at a Selection Panel held on 13 December 2017. On the basis of these presentations together with independent analysis of each fund's strategy, their respective Fund and Fee structures and their historic performance, the following split of investment was decided by the Property Acquisition Cross Party Working Group :

- Jupiter Unit Trust Managers Ltd £3 million
- JP Morgan Asset Management £5 million
- Aberdeen Asset Management £2 million

All three investments were placed with these Funds in February 2018.

9.5 **Property Acquisitions** – The purchase of commercial properties is not deemed a Treasury Management investment but a Service Investment. However there is a direct impact upon Treasury Management on the basis that any such purchase reduces the level of investable cash balances. Treasury officers will continue to liaise closely with Legal and Property to ensure that cash is available at the appropriate time to facilitate the further purchase of commercial properties using a further £10m of cash balances, as approved by Full Council in June 2017.

9.6 **MiFID II -** From 3 January 2018 new EU legislation came into force that does impact upon the authority's treasury management activity. MiFID II (Markets in Financial Instruments Directive) is aimed at increasing investor protection by creating a more efficient, risk-aware and transparent market for investment services and activities. This legislation required the FCA to treat all local authorities as Retail Clients but did allow local authorities to opt up to an Elective

Professional Client status if they met certain pre-determined criteria. The Council was not obliged to opt up but by not doing so could have precluded the Council from dealing with certain institutions or funds. The Council has opted up to Elective Professional Client status with all the institutions that required it to do so.

9.7 **Risk Management –** Any risks associated with the treasury management activities are managed through the Treasury Management Strategy and the Annual Investment Strategy.

10. CASHFLOW FORECASTING

10.1 During 2017-18, the Council diversified its investment activity further by placing £10m in Multi-Asset Funds.

10.2 As part of its treasury management responsibilities, the Finance & Audit Committee have been updated during the year of the Council's projected cashflow position. The model continues to be updated and will be presented to members of the Finance and Audit Committee at the next opportunity to reflect:

- The favourable provisional revenue outturn position for both the General Fund and the Housing Revenue Account
- The provisional outturn of the capital programme for both the General Fund and the Housing Revenue Account, including slippage from 2017-18.

11. BACKGROUND PAPERS

11.1 There are no Background Papers pertaining to this Report.

Prudential and treasury indicators Appendix A

1. PRUDENTIAL INDICATORS	2016-17	2017-18	2017-18
	actual	original	actual
	£m	£m	£m
Capital Expenditure			
Non - HRA	£13.507	£4,819	£5,095
HRA	£8.328	£13,155	£12,657
TOTAL	£21.835	£17,974	£17,752
Ratio of financing costs to net revenue stream (This is the proportion of annual debt financing costs as a percentage of the council's annual budget requirement)			
Non - HRA	2.06%		6.26%
HRA	20.01%		23.28%
Gross borrowing requirement			
brought forward 1 April	£104.781	£101,676	£101.677
carried forward 31 March	£101.677	£100,891	£98.082
in year borrowing requirement	£3.104	(£1,285)	£3.595
Gross Debt	£101.677	£103.391	£98.082
Capital Financing Requirement (CFR) as at 31 March (This is the amount of capital spending that has not been financed by capital receipts, capital grants of contributions from revenue)			
Non – HRA	£20.375	£20.290	£20.167
HRA (applies only to housing authorities)	£92.169	£88.665	£88.665
TOTAL	£112.544	£108.955	£108.832
Annual change in Cap. Financing Requirement			
Non – HRA	£9.803	(£0.089)	(£0.208)
HRA (applies only to housing authorities)	(£3.024)	(£3.504)	(£3.504)
TOTAL	£6.779	(£3,593)	(£3.712)
Incremental impact of capital investment decisions	**£ p**		**£ p**
Increase in council tax (band D) per annum *	£2.82		£2.43
Increase in average housing rent per week	N/A		N/A

2. TREASURY MANAGEMENT INDICATORS	2016/17	2017/18	2017/18
	Actual	**Original**	**Actual**
	£'000	**£'000**	**£'000**
Authorised Limit for external debt (This is the maximum amount of borrowing which the council is permitted to undertake on a temporary basis to manage cash flow demands)			
borrowing	£126,500	£126,500	£126,500
other long term liabilities	£1,600	£1,600	£1,600
TOTAL	£128,100	£128,100	£128,100
Operational Boundary for external debt (This is the maximum amount of borrowing which the council is permitted to undertake on a day to day basis and must not be breached other than for temporary cash flow demand purposes)			
borrowing	£125,000	£125,000	£125,000
other long term liabilities	£1,500	£1,500	£1,500
TOTAL	£126,500	£126,500	£126,500
Actual external debt	£101.677	£100.391	£98.082
Upper limit for fixed interest rate exposure			
Net interest re fixed rate borrowing / investments	100 %	100 %	100 %
Upper limit for variable rate exposure			
Net interest re variable rate borrowing / investments	25 %	25 %	25 %
Upper limit for total principal sums invested for over 364 days	£10,000	£10,000	£10,000

Maturity structure of fixed rate borrowing during 2017/18	Lower limit	Upper limit
under 12 months	0%	50%
12 months and within 24 months	0%	50%
24 months and within 5 years	0%	75%
5 years and within 10 years	0%	75%
10 years and within 15 years	0%	100%
15 years and within 20 years	0%	100%
Greater than 20 years	0%	100%

Note: The figures shown in the tables above reflect the position as at the date of reporting. They are subject to change during the final accounts process.

IMPLICATIONS	APPENDIX 3
Legal	As per Section 1.13B.67 of the Council's constitution, the Chief Finance Officer has delegated responsibility from Cabinet "in respect of borrowing and investments to arrange such loans as are legally permitted to meet the Council's borrowing requirements".
Finance and Value for Money	Due to the nature of the report, the financial implications are contained within the report. In order to achieve a balanced budget, the authority relies upon generating maximum interest from its investments whilst minimising and managing the exposure to risk. In order to achieve this, investments are only placed with institutions which meet the criteria set out within the TMSS. Where the authority is required to borrow to meet the needs of the authority, officers will seek advice from Capita Asset Services on timings and options in order to ensure the best deal for the authority.
Risk Assessment	A summary of the perceived risks associated with Treasury Management were identified in the Treasury Management Strategy approved by Council on 21 February 2017. Officers continue to monitor the risks on a day to day basis and identify mitigating actions to minimise risks.
Equality Impact Assessment	**Screening for Equality Impacts**
	Question
	a. Does the decision being made or recommended through this paper have potential to cause adverse impact or discriminate against different groups in the community? If yes, please explain answer. No
	b. Does the decision being made or recommended through this paper make a positive contribution to promoting equality? If yes, please explain answer. No
	In submitting this report, the Chief Officer doing so is confirming that they have given due regard to the equality impacts of the decision being considered, as noted in the table above
Corporate Plan	Corporate Plan Objective 4 - Sound and Self Sufficient Council
Crime and Disorder	N/A
Digital and website implications	No direct implications.

Safeguarding children and vulnerable adults	**N/A**