Derby City Council

COUNCIL CABINET
18 November 2018

ITEM 19

Report of Strategic Director of Corporate Resources

Treasury Management Mid-Year Report 2018/19

SUMMARY

1.1 The Council is required under the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the "CIPFA TM Code") to approve treasury management mid-year and outturn reports.

1.2 This mid-year report outlines the Treasury Management activity for the period 1 April 2018 to 30 September 2018, comprising:

- Summary of the Financial Markets to date in 2018/19
- Forecast Outturn 2018/19
- Borrowing Activity
- Deposits
- Prudential Indicators.

1.3 The Treasury Management forecast outturn for 2018/19 is a net underspend of £0.450m as at 30 September 2018. This underspend is mainly due to investment income forecast being revised and a reduction in the Minimum Revenue Provision (MRP) charges.

1.4 At the end of September 2018, total debt is £447.584m and total investments are £71.277m compared to £458.540m and £ £99.240m as at 1 April 2018, and no new borrowings have been made in the year to date.

1.5 All Treasury Management activities of the Council up to 30 September 2018 have complied with Prudential Indicators.

1.6 Treasury Management advice to the Council up to 30 September 2018 has been provided by Arlingclose. Their services includes economic and interest rate forecasting, advice on strategy, portfolio structure, debt restructuring, investment policy and credit ratings and technical assistance on other treasury matters as and when required.

RECOMMENDATION

2.1 To note the forecast outturn position of £0.450m underspend.

2.2 To note the position statement on Treasury Management Activity and compliance with the Prudential Indicators for the period 1 April 2018 to 30 September 2018.

REASONS FOR RECOMMENDATION

3.1 In accordance with CIPFA Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code"), it is considered good Treasury Management practice for members to note the progress and monitor performance at least twice a year. This report covers the progress of this activity.

SUPPORTING INFORMATION

4. Background

4.1 The Council's treasury management strategy for 2018/19 was approved by Full Council on 24 January 2018. The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Council's treasury management strategy.

4.2 The Council has adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2011 Edition (the CIPFA TM Code). Following consultation in 2017, CIPFA published new versions of the Prudential Code for Capital Finance in Local Authorities (Prudential Code) and the Treasury Management Code of Practice but has yet to publish the local authority specific Guidance Notes to the latter. In England the Ministry of Housing, Communities and Local Government (MHCLG) published its revised Investment Guidance which came into effect from April 2018.

4.3 The updated Prudential Code includes a new requirement for local authorities to provide a Capital Strategy, which is to be a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Council will be producing its Capital Strategy complying with the new CIPFA's requirements later in 2018/19 for approval by Full Council.

5. The Financial Markets to date in 2018/19

5.1 The Bank of England's Monetary Policy Committee (MPC) made no change to monetary policy at its meeting in May and June, but raised the Bank Rate to 0.75% from 0.5% in August 2018.

5.2 The increase in Bank Rate resulted in higher money markets rates. 1-month, 3-month and 12-month London Interbank Bid Rate (LIBID) rates averaged 0.56%, 0.70% and 0.95% respectively over the period.

5.3 Public Works Loan Board (PWLB) rates available to the Council are currently based on gilts plus 0.80%. Gilt yields have shown volatility during 2018/19 to date, however the overall change in gilt yields has been small. The yield on the 5-year gilts has risen marginally from 1.13% to 1.16%. The yield on 10-year gilts has had a larger increase from 1.37% to 1.57% and 20-year gilts increased from 1.74% to 1.89%.

5.4 The information relating to the overall global position of the UK financial markets is provided by Arlingclose, our treasury advisors, who continue to update the Council with on-going market activity and interest rates.

6 Local Context

6.1 On 31st March 2018, the Council had net borrowing of £263.964m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors are summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31.3.18 Actual £m
General Fund CFR	404.453
HRA CFR	**231.372**
Total CFR	**635.825**
Less: Other debt liabilities *	-95.789
Borrowing CFR	**540.036**
Less: Usable reserves	-238.958
Less: Working capital	-37.114
Net borrowing	**263.964**

*Finance leases, PFI liabilities and transferred debt that form part of the Council's total debt

6.2 The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low.

6.3 The treasury management position at 30th September 2018 and the change during the period is show in Table 2 below.

Table 2: Treasury Management Summary

	31 March 2018 Balance £m	Movement £m	30 Sept 2018 Balance £m	30.9.18 Rate %
Long-term borrowing	351.622	0.000	351.622	4.39%
Short-term borrowing	11.582	-10.760	0.822	1.99%
Total borrowing	**363.204**	-10.760	**352.444**	**4.39%**
Long-term investments	-0.000	0.000	-0.000	0.00%
Short-term investments	-34.000	9.000	-25.000	0.83%
Cash and cash equivalents	-65.240	18.963	-46.277	0.64%
Total investments	**-99.240**	27.963	**-71.277**	**0.72%**
Net Borrowing	**263.964**	17.203	**281.167**	

6.4 Net borrowing has increased during the year to 30 September 2018. This is due to a reduction in borrowing and a reduction in investments. Both borrowing and investments have fallen due to repayment of loans at maturity and investments have also fallen due to pension contribution payments being paid two years in advance, to generate a revenue saving.

7. Forecast Outturn 2018/19

7.1 The Treasury Management forecast outturn for 2018/19 is a net underspend of £0.450m as at 30 September 2018. This underspend is mainly due to investment income being revised to reflect changes in forecast balances and interest rates and a reduction in the Minimum Revenue Provision (MRP) charges. MRP charges for unsupported borrowing commence the year after the capital spend is incurred or the year after the asset becomes operational if later, therefore slippage in capital expenditure in 2017/18 has reduced the forecast MRP charges in 2018/19.

7.2 It is proposed any underspend on Treasury Management is to be transferred to the Treasury Management Reserve to help smooth future volatility in the treasury management costs and to fund potential project support costs in 2019/20 associated with potentially changing bank account provider following the banking services tender.

8. Treasury Borrowing Activity

8.1 At the 30 September 2018 the total external debt portfolio of the Council (including HRA debt and other long- term liabilities) was £447.584m, as a result of its strategy for funding previous years' capital programmes. The analysis of external debt outstanding at 30 September 2018 is shown in the table 3 below:

Table 3: External Debt at 31 March 2018 and 30 September 2018

	£m	£m
	As at 31 March 2018	**As at 30 Sept 2018**
External Borrowing:		
- Fixed Rate PWLB	304.347	303.733
- Fixed Rate Market (LOBO)	20.000	20.000
- Other Local Authorities	35.000	25.000
- Local Enterprise Partnership (LEP)	1.710	1.564
- SALIX Energy Efficiency	1.347	1.347
- University of Derby	0.800	0.800
Total External Borrowing	**363.204**	**352.444**
Other Long-term Liabilities:		
- Transferred Debt from other Local Authorities	0.453	0.453
- PFI Financing	94.883	94.687
Total Gross External Debt	**458.540**	**447.584**

8.2 The LEP, University of Derby and SALIX loans were loans for specific projects offered at favourable rates. The LEP loans are at 1.91% and 2.68% and are 0.40% less than PWLB rates at the time each loan was taken. The University of Derby and SALIX loans are at 0% interest, taking the interest free loans helps maintain our cash levels available for investment whilst having no cost to the Council.

8.3 In such times as ongoing volatility in the financial markets, the Council's main objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Council's long-term plans change being a secondary objective.

8.4 In keeping with these objectives, no new borrowing was undertaken, while £10.760m of existing loans were allowed to mature without replacement. This strategy enabled the Council to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

8.5 The Council continues to hold £20m of Lender's Option Borrower's Option (LOBO) loans where the lender (Royal Bank of Scotland Plc) has the option to propose an increase in the interest rate as set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. No banks exercised their option during the period.

9. Treasury Investment Activity

9.1 The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the six-month period to 30 September 2018, the Council's investment balance ranged between £71.277m and £129.255m due to the repayment of loans at maturity, pension contribution payments made in advance and timing differences between income and expenditure. The investment position is show in table 4 below.

Table 4: Treasury Investment Summary

Counterparty	31 March 2018 Balance £m	Net Movement £m	30 Sept 2018 Balance £m
Banks & building societies (unsecured)	0.889	5.966	6.855
Local authorities	50.000	-22.000	28.000
Money Market Funds	48.351	-11.929	36.422
Total investments	**99.240**	**-27.963**	**71.277**

9.2 The investment activity to the 30 September 2018 together with a comparison for the previous year is summarised in table 5 below:

Table 5: Treasury Investment Activity

	2017/18	2018/19 to September 2018
Number of fixed-term deposits made	35	15
Number of instant access and money market accounts used	15	14
Number of deposits/withdrawals from money market funds/ call accounts	89	68
Value of deposits/ investments held at 31 March	£99.240m	£71.277m
Average size of deposit/ investment portfolio	£94.023m	£96.965m
Average size of Lloyds Balance (operational)	£8.904m	£9.202m
Total interest earned on deposits/ investments (including Lloyds)	£0.343m	£0.320m
Average Return on deposits/ investment portfolio	0.33%	0.56%

9.3 Both the CIPFA Code and government guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

9.4 In furtherance of these objectives, and given the increasing risk and low returns from short-term unsecured bank investments, the Council has continued to keep the use of these to a minimum. It has continued to use fixed term deposits with other Local Authorities, although at lower levels than in the previous year, whilst higher levels of investments have been held in Money Market Funds (MMF) during the year to date. This is due to the forecast requirement to make a large payment in year but the exact timing of the payment is not known meaning the cash must be held to enable instant access. MMF's give instant access.

9.5 The credit risk and return metrics for the Council investments extracted from Arlingclose's quarterly investment benchmarking is shown in table 6.

9.6 **Table 6: Investment Benchmarking**

	Credit Score*	**Credit Rating**	**Bail-in Exposure**	**WAM** (days)**	**Rate of Return**
31/03/2018	4.15	AA-	48%	26	0.49%
30/09/2018	4.46	AA-	58%	50	0.72%
Similar LAs	4.53	A+	66%	52	1.49%
All LAs	4.38	AA-	60%	37	1.25%

*The lower the credit score the lower risk
** Weighted Average Maturity

9.7 This shows the Council's exposure to bail-in and credit score has increased during the period to 30 September 2018 which is consistent with the position outlined in 9.3 regarding greater use of MMF's and less use of use fixed term deposits with other Local Authorities. Bail-in exposure means the percentage of the portfolio that is held in investments where bail-in regulations apply. Bail-in legislation, ensures that large investors including local authorities will rescue failing banks instead of taxpayers. Call accounts and MMF's are subject to bail-in, fixed term deposits with local Authorities are not subject to bail-in. The benchmarking only highlights the Council's exposure to bail-in; it does not consider the likelihood of a bail-in. Treasury Advisors continue to keep the Council informed of any emerging position surrounding banks and MMF's and changes impacting on the likelihood of bail-in and appropriate action would be taken.

9.8 The Weighted Average Maturity (WAM) for investments has increased as although the use of fixed term deposits have fallen, where they have been used it has been for longer periods to achieve a greater return, this has been pursued due to forecasting showing the cash will not be required before the maturity dates. The Council's benchmarking shows the it has a lower credit score and bail in exposure than of Similar Local Authorities (LA's), being other Unitary Councils, demonstrating the Council continues to pursue security and low risk.

10. Non-Treasury Investments

10.1 The definition of investments in the revised "CIPFA TM Code" now covers all the financial assets of the Council as well as other non-financial assets which the Council holds primarily for financial return. This is replicated in MHCLG's Investment Guidance, in which the definition of investments is further broadened to also include all such assets held partially for financial return. The Council's Non-Treasury Investments are shown in table 7:

Table 7: Non Treasury Investments as at 30 September 2018

Type of investment	**Investment value £m**	**Return £m**	**Rate of Return %**
Directly owned investment property*	1.336	0.100	7.49%
Loans to local businesses	3.909	0.093	4.40%
Loans to subsidiaries (Derby Homes)**	3.027	0.163	5.38%

*Investment value and return taken from the 2017/18 statement of accounts to give an indication of 2018/19 position – this will not be known until the end 2018/19.
** This is the full year position as an annual interest is charged

11. Compliance Report

11.1 All treasury management activities undertaken up to 30 September 2018 complied fully with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy. Compliance with specific investment limits are demonstrated in table 8 below.

Table 8: Investment Limits

	2018/19 Maximum to date	30/9/18 Actual	2018/19 Limit	Complied
The Councils Banking Provider – Lloyds	£15m	£11.730m	£15m	✓
Any single organisation, except the UK Central Government (excluding the operational bank)	£10m	£10m	£10m	✓
Any group of pooled funds under the same management	£10.790m	£10.790m	£20m	✓
Money Market Funds (MMF)	£8m	£8m	£8m	✓

11.2 Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 9 below.

Table 9: Debt Limits

	2018/19 Maximum £m	30/09/18 Actual £m	2018/19 Operational Boundary £m	2018/19 Authorised Limit £m	Complied
Borrowing	363.2	352.5	632.2	765.9	✓
PFI & finance leases	95.3	95.1	102.0	102	✓
Total debt	**458.5**	**447.6**	**734.2**	**867.9**	

12. Treasury Management Indicators

12.1 The Council measures and manages its exposures to treasury management risks using the following indicators.

12.2 **Security:** The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit score of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

12.3 Local Authorities are unrated, therefore fixed term deposits with Local Authorities have to be assigned a score. The score assigned is AAA=1, this means the investments are of the highest credit quality. This is due to Local Authorities not being subject to bail-in and having an insignificant risk of insolvency.

12.4 Table 10 shows the target for the portfolio average credit score and the actual to 30 September 2018/19:

Table 10: Security Indicator - Portfolio average credit score

	Target	Actual
Portfolio average credit score	3.00	1.48

12.5 The actual credit score is below the target showing the exposure to credit risk for the year to date has been lower than the target set, this is due to higher credit quality investment being used over lower credit quality investment. This is due to the using fixed term deposits with Local Authorities and high credit quality Money Market Funds (MMF's).

12.6 **Interest rate exposure indicator:** The other locally-set prudential indicator relates to interest rate exposure which allows the Council to manage the extent to which it is exposed to changes in interest rates. It shows the split of borrowing and investments between fixed and variable rates, and the maturity profile of long term loans. Fixed investments and borrowings are those where the rate of interest is fixed for the whole financial year or from the transaction date if later. Instruments that mature during the following financial year are classed as variable rate.

The split in respect of borrowing and investments as at 30 September 2018, and the comparative figures for the previous year, are shown in Table 11 below:

Table 11: Interest Rate Exposure

	2017/18	2018/19 as at 30 Sept 2018
	%	%
Upper Limit on fixed interest rate Exposure	100	100
Actual	87.11	83.20
Upper Limit on variable interest rate exposure	20	20
Actual	12.89	16.80

12.7 These figures show that the Council has not exceeded any limits for the fixed and variable rate borrowing. The increase in variable interest rate exposure as at 30 September 2018 is due to two loans being repaid in the first half of 2019/20.

12.8 **Maturity Structure of Borrowing:** The actual maturity structure of borrowing as at 30 September 2018 has been compared to the loan maturity limit profile that was approved in the Treasury Management Strategy 2018/19. Table 12 below shows that this indicator has been met as follows:

Table 12: Maturity Structure of Borrowing

Number of Years to Maturity	Upper limit per 2018/19 Strategy	Actual Profile of Borrowing at 30 September 2018
	%	%
Up to 1 year	10	0.07
Up to 2 years	20	3.15
Up to 5 years	30	5.63
Up to 10 years	50	11.66
Up to 20 years	70	31.07
Up to 30 years	80	38.34
Up to 40 years	95	85.93
Up to 50 years	100	100.00

12.9 **Principal Sums Invested for Periods Longer than 365 days**: The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:

Table 13: Principal Sums Invested for Periods Longer than 365 days

	2018/19 £m
Actual principal invested beyond year end	0.00
Limit on principal invested beyond year end	30.00
Complied?	✓

13. Economic Outlook for the remainder of 2018/19

13.1 The Bank of England's Monetary Policy Committee (MPC) has maintained expectations of a slow rise in interest rates over the forecast horizon. Arlingclose's forecast expectations are for Bank Rate to rise twice in 2019, by 0.25% in March 2019 and a further 0.25% in September 2019.

13.2 The view is that the UK economy still faces a challenging outlook as the minority government continues to negotiate the country's exit from the European Union. Central bank actions and geopolitical risks, such as prospective trade wars, have and will continue to produce significant volatility in financial markets, including bond markets.

14. OTHER OPTIONS CONSIDERED

14.1 None considered.

This report has been approved by the following officers:

Legal officer	
Financial officer	Toni Nash, Head of Finance
Human Resources officer	
Estates/Property officer	
Service Director(s)	Don McLure, Corporate Director of Strategic Resource
Other(s)	

For more information contact:	Bev Bull Principal Accountant 01332 643350 bev.bull@derby.gov.uk
Background papers:	None
List of appendices:	Appendix 1 – Implications

Appendix 1

IMPLICATIONS

Financial and Value for Money

1.1 As described in the report.

Legal

2.1 None.

Personnel

3.1 None directly arising.

IT

4.1 None.

Equalities Impact

5.1 None directly arising.

Health and Safety

6.1 None.

Environmental Sustainability

7.1 None.

Property and Asset Management

8.1 None.

Risk Management

9.1 The Council has adopted the CIPFA Prudential Code for Capital Finance which is designed to balance the financial risks of investment and borrowing activities with value for money.

9.2 The risks associated with investments/borrowing are detailed in the main body of the report.

Corporate objectives and priorities for change

10.1 None.

Glossary of Treasury Management Terms	
Term	**Description**
Bail-in	Investors take a loss on their investment to rescue a failing bank. It is alternative to a bail- out of a failing bank, where the loss is made good by the governments and taxpayers.
Bank Rate	The official interest rate set by the Bank of England's Monetary Policy Committee and what is generally termed at the "base rate".
Call Accounts	A call account is a bank account for investment funds it has no fixed deposit period, provides instant access to funds and allows unlimited withdrawals and deposits.
Gilts	Gilts are a UK government liability in sterling, issued by HM Treasury and listed on the London Stock Exchange. Being issued by the UK government, they are deemed to be very secure as the investor expects to receive the full face value of the bond to be repaid on maturity.
London Interbank Bid Rate (LIBID)	The London interbank market is a wholesale money market in London where banks exchange monies. The bid rate is the rate London banks are willing to pay for deposits and other banks' unsecured funds from other banks in the London interbank market.
Money Market Fund (MMF)	Pooled funds which invest in a range of short term assets providing high credit quality and high liquidity.
Monetary Policy Committee (MPC)	The Monetary Policy Committee (MPC) is a committee of the Bank of England who decides what monetary policy action to take. The MPC sets and announces policy eight times a year.
Public Works Loan Board (PWLB)	The Public Works Loan Board (PWLB) is a statutory body operating within the United Kingdom Debt Management Office, an Executive Agency of HM Treasury. PWLB's function is to lend money from the National Loans Fund to local authorities, and to collect the repayments.
Weighted Average Maturity (WAM)	The average number of days remaining until the investment matures weighted by the value of each investment.