Part I – Release to Press

Stevenage BOROUGH COUNCIL

Meeting:	**Audit Committee / Executive / Council**
Portfolio Area:	Resources
Date:	**20 November / 21 November / 18 December 2018**

2018/19 MID YEAR TREASURY MANAGEMENT REVIEW

NON-KEY DECISION

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1. PURPOSE

1.1 To update members on the Treasury Management activities in 2018/19 and review effectiveness of the 2018/19 Treasury Management and Investment Strategy including the 2018/19 prudential and treasury indicators.

2. RECOMMENDATIONS

2.1 That subject to any comments from Executive and the Audit Committee, recommend to Council to approve the 2018/19 Treasury Management Mid-Year review.

2.2 That subject to any comments from Executive and the Audit Committee, recommend Council to approve the latest approved Countries for investments (paragraph 4.7.13 Appendix D).

2.3 That subject to any comments from Executive and the Audit Committee, recommend to Council that officers may undertake treasury management functions on behalf of Council wholly owned companies and or Council Limited Liability Partnership (LLP) subject to authorisation from the Board of Directors (see paragraph 4.7.12)

3. BACKGROUND

3.1 The Council is required under the Local Government Act 2003 to produce a Mid Year Treasury Management Report reviewing treasury management activities including the 2018/19 prudential and treasury indicators. In addition the report meets the requirements of both the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code). Both these documents were revised and updated in 2017. As from 2019/20 all local authorities will be required to prepare a Capital Strategy that provides:

- High level overview of how capital strategy, capital financing and treasury management activities contribute to council services,
- how the associated risk is managed,
- and implications for the future financial sustainability of the council.

Officers will be incorporating these elements into the 2019/20 Capital strategy to be approved by Council on 27 February 2019.

3.2. This report covers one of three reporting requirements under the code of practice, the other reports being;

- Annual Treasury Strategy (in advance of the year) (last reported to Council 28 February 2018)
- Annual Treasury Management Review after the year end (2017/18 was reported to Council 17 October 2018)

3.3 This report summarises:

- Capital expenditure for 2018/19;
- Impact of the expenditure on the Council's underlying indebtedness, (the Capital Financing Requirement);
- Reporting of the required prudential and treasury indicators;
- Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances;
- Summary of interest rates currently available;
- Detailed debt and investment activity; and
- An economic update for the first part of 2018/19.

4 REASONS FOR RECOMMENDED COURSE OF ACTION AND OTHER OPTIONS

4.1 The Council's Capital Expenditure and Financing 2018/19

4.1.1 Capital expenditure[1] can be financed either by capital resources the Council has on its balance sheet (e.g. capital receipts & capital grants) or by making a revenue contribution to capital. If sufficient capital resources are not available to fund the expenditure the council would need to borrow to meet the funding gap. This borrowing may be taken externally in new loans or internally from cash

[1] Council expenditure can be classified as capital when it is used to purchase assets with a life of more than one year, exceeds £5,000 in value and meets the guidelines laid out in CIPFA accounting practises.

balances held by the council (see also 4.2.2). The need to borrow is measured and reported through the prudential indicators.

4.1.2 The Treasury Strategy and Prudential Indicators for 2018/19 were originally approved by Council on the 28 February 2018. Since then, capital budget changes have been approved and the Prudential Indicators updated in the 2017/18 Annual Treasury Management Review (approved by Council on the17 October 2018). The Treasury Management Mid-Year Review Indicators have been updated based on the 1st quarter capital programme reported to Executive (5 September 2018).

4.1.3 Table One (shown below) shows the original capital programme, the revised capital programme (approval Executive 5 September 2018) and financing.

Table One: 2018/19 Capital Expenditure and Financing		
	2018/19 **Original Estimate** **£'000**	**2018/19** **Revised Mid-Year Review (Executive September 2018)** **£'000**
Capital Expenditure:		
General Fund Capital Expenditure	32,806	32,007
HRA Capital Expenditure	23,228	26,128
Total Capital Expenditure	**56,033**	**58,135**
• Capital Receipts	(9,601)	(10,303)
• Capital Grants / Contributions	(8,483)	(7,083)
• Capital Reserves	(1,748)	(1,648)
• Revenue contributions	(8,092)	(8,092)
• Major Repairs Reserve	(9,028)	(9,028)
Total Resources Available	**(36,953)**	**(36,154)**
Capital Expenditure Requiring Borrowing	**(19,081)**	**(21,981)**

4.2 The Council's overall borrowing position.

4.2.1 The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR)[2]. Whether physical borrowing is taken out depends on the level of cash balances held by the Council. Based on the Capital Strategy and Treasury Management Strategy, the treasury service manages the Council's cash position to ensure sufficient cash is available to meet the capital payments. This may be through borrowing from utilising cash balances held by the Council in the short to medium term or external bodies

[2] Capital Financing Requirement (CFR) represents the amount of debt the Council needs to/has taken to fund the capital programme after debt repayments and Minimum Revenue Provision (MRP) are taken into account

(such as the Government, through the Public Works Loan Board (PWLB) or the money markets).

4.2.2 The Council has not undertaken any new physical borrowing as at 15 October 2018.

4.2.3 In 2018/19 the average cash holding between April and September was £64Million (£70.7Million April to September 2017/18). While investment returns are low the "internal" borrowing rate is significantly cheaper than the cost of external borrowing and remains a prudent use of the Council's cash balances, unless the condition in para 4.3.1 apply.

4.2.4 As at the 30 September 2018 the Council had total external borrowing of £205,614,160 (projected to increase to £227,463,331 by 31 March 2019 if all approved borrowing is taken). When expenditure is incurred on the purchase of commercial property the decision to take out the remaining of approved borrowing (£15million) will be reviewed. To accelerate the purchase process, an agent has been appointed towards end of September and they have three months to seek opportunities which will take us to the end of December. In the meantime other purchase options are also currently being pursued.

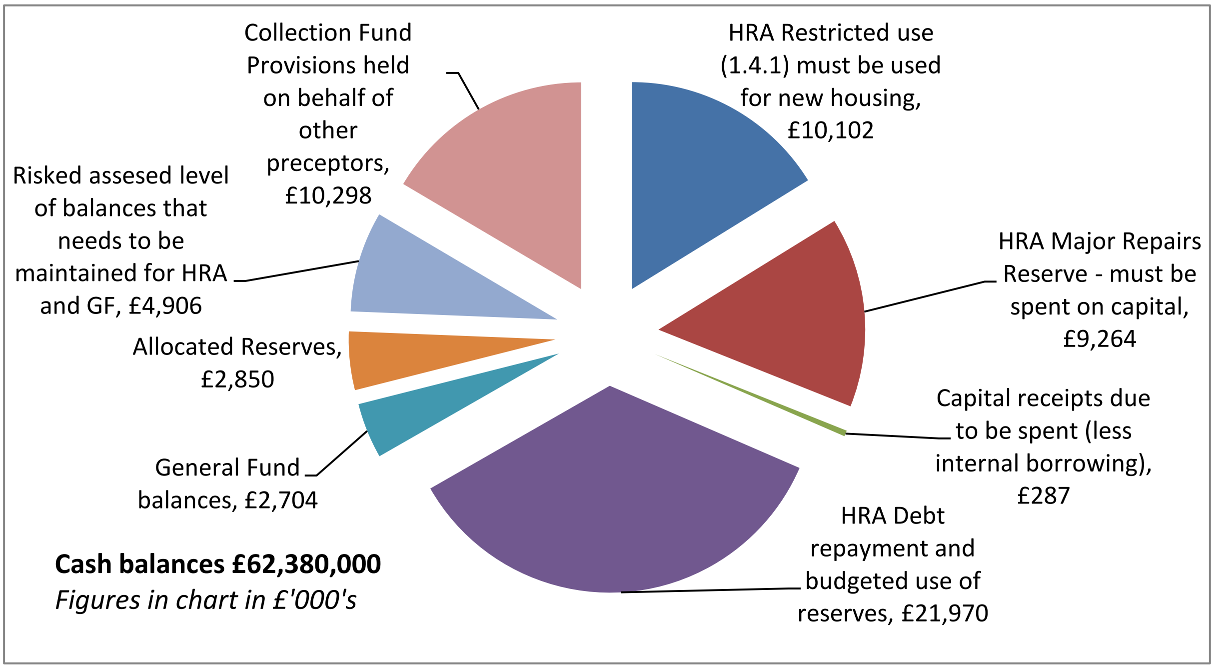
4.2.5 The General Fund has £2,940,160 external borrowing with the PWLB. The HRA has external borrowing of £202,674,000 with the PWLB, with the majority of the HRA debt (£194,911,000) taken out in March 2012 to finance the payment required to central government for self-financing. This debt was arranged over a number of loans at fixed rates and with varying maturities

4.2.6 The HRA borrowing includes £7,763,000 used to fund the pre 2012 decent homes programme. This debt was called 'supported borrowing' under the former HRA subsidy system but now forms part of the HRA debt portfolio. . The remaining difference between the HRA debt portfolio and CFR at 31 March 2019 is the result of asset transfers from General Fund to the HRA and HRA internal borrowing prior to self-financing.

4.2.7 HRA borrowing was constrained by legislation (unlike the General Fund) and was capped at £217,685,000. In the autumn budget statement it was confirmed that **the borrowing cap on local authorities with housing revenue accounts (HRA) will be abolished completely with immediate effect.** Going forward the constraint on HRA borrowing will be based on affordability rather than legislation. The approved prudential indicators contained within this report (operational boundary and authorised limit for borrowing (see paragraph 4.4.6)) are based on the HRA debt cap pre autumn statement. These limits will be reviewed and updated following approval of the HRA 2019/20 budget and the Capital Strategy.

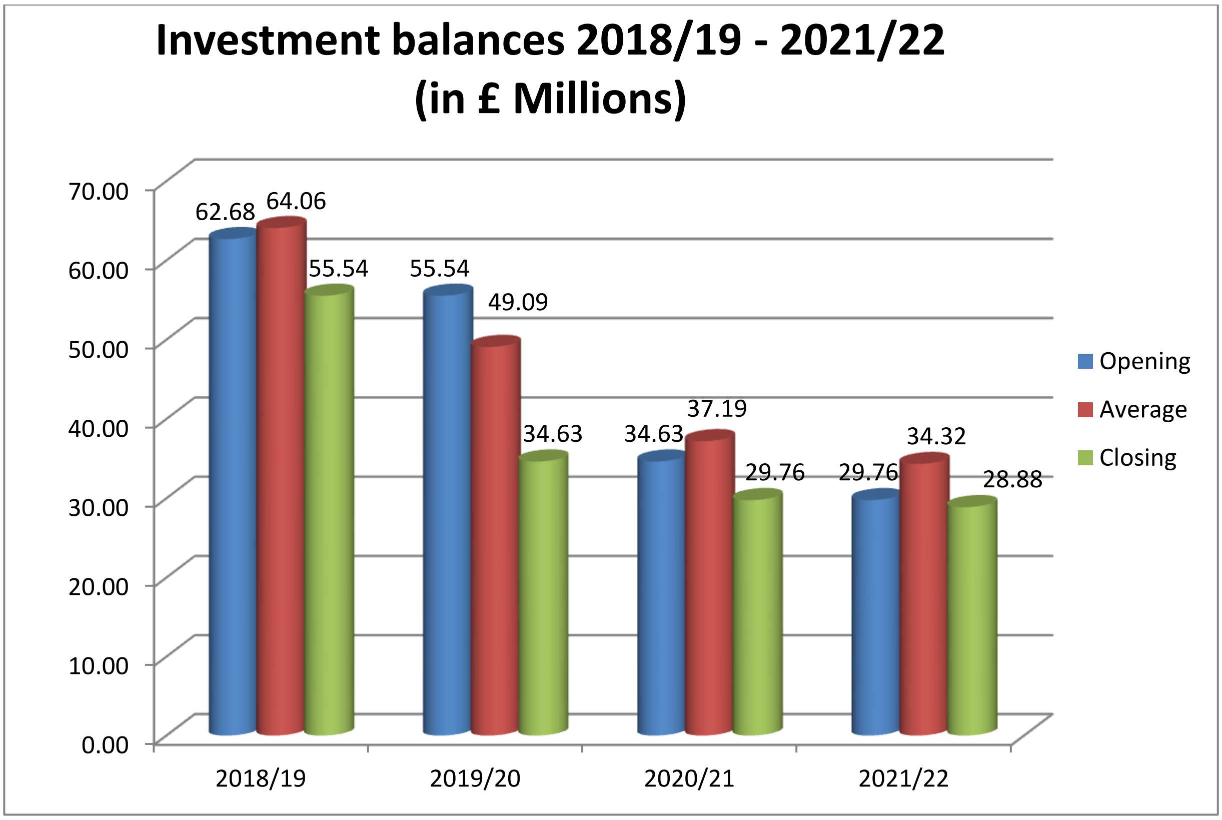
4.3 Cash balances and cash flow management

4.3.1 As at 1 April 2018 cash balances held by SBC totalled £62.4Million. As seen in the following pie chart most of these sums are held on behalf of other parties (Collection Fund – Hertfordshire County Council, Police and Central Government) or their use is restricted to capital projects which have already been identified.



4.3.2 Currently cash balances are estimated to be £55.5Million by 31 March 2019, but is dependent on current spending projections and approved borrowing included in the capital strategy and HRA business plan (General Fund - £15.581million and HRA - £6.4Million) for 2018/19. Decisions as to when this borrowing is actually taken will be considered based on cash balances and anticipated interest rates.

Chart One: Investment Balances forecast



4.4 Prudential Indicators

4.4.1 It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. The Council's approved Treasury and Prudential Indicators, (which affordability limits), are included in the approved Treasury Management Strategy and an update on those indicators is included in this report. During the year to 21 November 2018, the Council has operated within the treasury and prudential indicators set out in that strategy. Further explanation of key prudential indicators is given below and is also shown in Appendix A.

4.4.2 **Borrowing and the 2018/19 Capital Financing Requirement (CFR)** - The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). The Council's original estimate and latest CFR for the year is shown below. The estimate of the CFR for 2018/19 has been updated for the capital strategy approved by Members (5 September 2018 Executive).

Table Two : Capital Financing Requirement 2018/19

CFR Calculation	2018/19 Original Estimate £'000	2018/19 Revised Annual Treasury Management Review of 2017/18 (Approved Council October 2018) £'000	2018/19 Revised Mid-Year Review (Executive November 2018) £'000
Opening Balance	**221,877**	**221,877**	**221,877**
Closing Capital Financing Requirement (General Fund)	35,666	35,666	29,835
Closing Capital Financing Requirement (Housing Revenue Account)	208,709	208,709	211,857
Closing Balance	**244,375**	**244,375**	**241,692**
Increase/ (Decrease)	**22,498**	**22,498**	**19,815**

4.4.3 Total debt repayments made in the first half of 2018/19 relating to principle on PWLB GF loans were £131,579 (paid in August) and a repayment of £1.241,000 in respect of HRA debt in April 2018. A further repayment of £131,579 will be made in February 2019 in relation to General Fund debt.

4.4.4 The Council could further reduce its CFR by:

- The application of additional capital financing resources (such as unapplied capital receipts) if available; or
- Charging more than the statutory revenue charge (Minimum Revenue Provision (MRP)) each year through a Voluntary Revenue Provision (VRP) which would increase the cost to the General Fund.

4.4.5 The **net borrowing position** of the Council at 31 March 2019 is estimated to be **£173,344K** of borrowing (total borrowings/loans of £227,463K less total investments held of £54,119K).

4.4.6 The **operational boundary and authorised limit** refer to the borrowing limits within which the treasury team operate. A temporary breach of the operational boundary is permissible for short term cash flow purposes however a breach of the authorised limit would require a report to Council. To date there have been **no breaches** of either limit in 2018/19. Both limits have been updated to reflect approved borrowing for the HRA and debt cap and approved prudential borrowing for the General Fund (see also paragraph 4.2.7).

4.4.7 **Minimum Revenue Provision** (MRP)[3] – In 2018/19 the MRP charged to the General Fund is £661,090, based on previous years' borrowing. At present the only borrowing included in this indicator relates to the ten year plan for the garages estate (£6.7million prudential borrowing over the period 2018/19 to 2020/21) and the investment property strategy (£13.24million in 2018/19 out of the £15M that was approved). MRP will need to be made regardless of whether actual external borrowing has been taken and hence differs from the treasury management arrangements, the latter considers utilising cash balances when borrowing rates are higher than investment interest rates (as in paragraph 4.2.2).

4.4.8 The **ratio of financing costs to net revenue stream** is equal to General Fund interest costs divided by the General Fund net revenue income from Council Tax and RSG/NDR. For 2018/19 this indicator has changed due to changes to MRP, re profiling of garages business plan and the revised capital programme figures are shown in Appendix A. In future years it increases due to approved borrowing for the investment property strategy which will contribute to General Fund financial security objectives.

4.4.9 The treasury management indicators for 2018/19 onwards have been calculated based on the 1st quarter capital programme reported to Executive 5 September 2018. There will be subsequent updates to the capital programme including the capital bidding process for the period 2019/20 to 2023/24 and as such the data relating to future years is indicative only and will be subject to change. The full list of Treasury Prudential Indicators is shown in Appendix A.

[3] MRP- The Council must base its borrowing decisions in accordance with the Prudential Code which requires the Council to demonstrate a need to borrow and to show the cost of that borrowing for the General Fund is affordable. The Council's MRP policy, as required by CIPFA guidance, is approved annually by Council as part of the Treasury Management Strategy. The calculation of MRP is based upon prior years' borrowing requirement and the life of the assets for which borrowing was required.

4.5 Update on Treasury Management Strategy Position 2018/19

4.5.1 The Council's debt and investment position is managed by the treasury management section to ensure adequate liquidity for revenue and capital activities. In addition, investment decisions are based on the security of the investments and spread over a number of counter parties to manage the Council's exposure to risk.

4.5.2 The Council's **average investment returns** are modest due to historically low Bank of England Base Rate which is currently 0.75% (see also para 4.8.3) and the risk appetite in the treasury management strategy. As at 30 September 2018 the 2018/19 average rate of interest being earned on investments was 0.77% this compares to 0.58% earned in 2017/18. This exceeded the 7 day LIBID benchmark rate of 0.59% (source: LINK Asset Services 30-9-18).

4.5.3 While costs for loans of between eight and ten years are around 2.35-2.50% (as at 12 October 2018) it is still prudent to utilise the Council's cash balances (as shown in paragraph 4.2.3) for short-term internal borrowing. However, borrowing costs are forecast to increase and officers will be determining whether it may be prudent to take some borrowing at lower interest rates based on the forecast reduction of future cash balances. The decision and timing of when to borrow is being monitored by officers.

4.5.4 The Council's treasury position for the first half of year was as follows;

Table three Treasury Position 2018/19						
	30 Sep 2018 Principal £'000s	**Rate / Return %**	**Average Life (Yrs)**	**31 Mar 2019 Principal £'000s**	**Rate / Return %**	**Average Life (Yrs)**
Fixed rate loans - PWLB	205,614	3.37	15.53	205,482	3.37	15.53
Approved Prudential Borrowing	15,581	TBC	TBC	15,581	TBC	TBC
Approved HRA Borrowing	6,400	TBC	TBC	6,400	TBC	TBC
Total Borrowing	**205,614**	**3.37**	**15.53**	**227,463**	**3.37**	**15.53**
CFR				241,692		
Over/(under) borrowing*				(14,229)		
Investments Portfolio	**69,450**	**0.54**		**54,119**	**0.54**	

** financed by internal borrowing*

4.5.5 The maturity structure of the debt portfolio was as follows (see also Appendix B):

Table four Maturity of Debt Portfolio for 2017/18 and 2018/19		
Time to maturity	**31 March 2018 Actual £'000's**	**30 September 2018 Actual £'000's**
Maturing within one year	3,004	263
1 year or more and less than 2 years	263	263
2 years or more and less than 5 years	790	658
5 years or more and less than 10 years	18,956	18,956
10 years or more	185,474	185,474
Total	**208,487**	**205,614**

4.5.6 There are seven investments with **maturities over one year** as detailed below:

Counterparty	Country	Rating	Deposit amount	Start date	Maturity on
Birmingham City Council	UK	AA	3,000,000	24/04/2017	24/04/2019
Spelthorne Borough Council	UK	AA	1,300,000	22/06/2017	21/06/2019
Newcastle upon Tyne City Council	UK	AA	1,000,000	03/04/2017	03/04/2020
London Borough of Barking and Dagenham	UK	AA	2,000,000	09/01/2017	09/04/2020
Lancashire County Council	UK	AA	2,300,000	06/09/2018	07/09/2020
Great Yarmouth BC	UK	AA	2,000,000	16/05/2018	17/05/2021
Barnsley Metropolitan Borough Council	UK	AA	2,700,000	15/09/2017	15/09/2021
			14,300,000		

All other investments held during the first half of 2018/19 are due to mature within one year. A summary of the Council's exposure to fixed and variable rate investments is shown below in Table Five. (See also Appendix B).

Table Five : Fixed and Variable Rate Investment Totals		
	31 March 2018 Actual £'000's	**30 September 2018 Actual £'000's**
Fixed rate principal	48,500	51,800
Variable rate principal	13,880	10,970
Total	62,380	62,770

4.5.7 The total limit on the amount invested in **Money Market Funds** was removed (Recommendation 2.5 Treasury Management Review including Prudential

Code – Council 28 Feb 2017) and no further Money Market funds have been added to the portfolio in 2018/19.

4.5.8 There have been **no breaches** of treasury **counter party limits**. Any breach would be notified to the Chief Finance Officer. There have been no pressures on counter party limits and no investments have been deposited with the DMO since October 2014 when Treasury Management limit changes were implemented.

4.5.9 The use of **enhanced cash funds** was also approved in February 2017. These funds are now referred to as “Ultra Short Dated Bond” (USDB) funds (Recommendation 2.7 Treasury Management Review including Prudential Code – Council 28 Feb 2017). Currently no investments have been made with USDB funds.

4.5.10 The updated list of “Approved Countries for Investments” is detailed in Appendix D.

4.5.11 Other Treasury Management Issues **- Money Market Fund Regulatory Change** The Money Market Fund sector is now in the last stages of introducing new regulations, expected to be finalised in early 2019. These will see existing non-government Constant Net Asset Value (CNAV) funds convert to Low Volatility Net Asset Value (LVNAV) pricing. Government-type funds will remain as “CNAV” funds under the new regulations. This change is not expected to impact on the existing treasury Management strategy.

4.5.12 As part of the Council regeneration programme and financial security objectives officers will be establishing special purpose vehicles (SPV) to deliver regeneration in the town and to improve the offer in the private rented sector. These SPV’s will include a Limited Liability partnership and wholly owned companies. As completely separate legal entities the board of Directors of the SPV will need to delegate authority for the treasury management function to the Council. This report seeks to gain approval from Members for officers to invest monies on behalf of the SPV’s subject to Director’s delegation. All sums invested on behalf of theses SPV’s will be done in accordance with the Councils own treasury management policies.

4.6 Economic Review & Interest Rate Outlook

4.6.1 **UK Growth**

The first half of 2018/19 saw the UK economy grow modesty and the Monetary Policy Committee, (MPC) voted (9-0) to increase Bank Rate on 2nd August from 0.5% to 0.75%. Although growth looks as if it will continue at around 1.5% in 2018, the Bank of England’s August Quarterly Inflation Report suggested that growth will pick up to 1.8% in 2019, caveated by whether or not the UK achieves an orderly withdrawal from the European Union in March 2019.

4.6.2 **Inflation and Bank Rate**

Some MPC members have expressed concerns about a build-up of inflationary pressures, particularly with the pound falling in value again against both the US dollar and the Euro. The Consumer Price Index (CPI) measure of inflation rose unexpectedly from 2.5% to **2.7% in August** due to increases in volatile components, but is expected to fall back to the 2% inflation target over the next two years given a scenario of minimal increases in Bank Rate. The MPC has indicated Bank Rate would need to be in the region of 1.5% by March 2021 for inflation to stay on track. Financial markets are currently pricing in the next increase in Bank Rate for the second half of 2019. Should interest rates increase by 0.25% annual interest costs for the Council would rise by £2,500 for every £1million of new borrowing taken.

4.6.3 **Wage inflation**

Unemployment remains at a 43 year low at 4% on the Independent Labour Organisation measure. A combination of job vacancies hitting an all-time high in July, together with negligible growth in total employment numbers, indicates that employers are now having major difficulties filling job vacancies with suitable staff. Wage inflation picked up to 2.9%, (3 month average regular pay, excluding bonuses) and to a one month figure in **July of 3.1%**. This meant that in real terms, (i.e. wage rates higher than CPI inflation), earnings grew by about 0.4%, near to the joint high of 0.5% since 2009. The MPC views wage inflation in excess of 3% as increasing inflationary pressures within the UK economy and hence its increase in Bank Rate in August.

4.6.4 **Eurozone Economy**

Eurozone growth has undershot early forecasts of a strong economic performance in 2018. In particular, data from Germany has been mixed and it could be negatively impacted by US tariffs on a significant part of its manufacturing exports e.g. cars. For that reason, growth is expected to be in the region of 2% for 2018.

4.6.5 **Brexit**

There is continued uncertainty as to the outcome of Brexit negotiation and a risk that the current Conservative minority government may be unable to muster a majority in the Commons over Brexit in March 2019. If the UK faces a general election in the next 12 months, this could result in a potential loosening of monetary policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up. Treasury advisors do not think that the MPC will increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. They also feel that the MPC is more likely to wait until August 2019, than May 2019, before the next increase, to be followed by further increases of 0.25% in May and November 2020 to reach 1.5%. However, this cautious approach will be dependent on the Brexit negotiations.

5. IMPLICATIONS

5.1 Financial Implications

5.1.1 This report is of a financial nature and reviews the treasury management function for the 2018/19. Any consequential financial impacts of the Strategy will be incorporated into the Capital Strategy updates and subsequent Quarterly budget monitoring reports.

5.2 Legal Implications

5.2.1 Approval of the Prudential Code Indicators and the Treasury Management Strategy Indicators are intended to ensure that the Council complies with relevant legislation and best practice.

5.3 Risk Implications

5.3.1 The current policy of not borrowing externally only remains financially viable while cash balances are high and the differentials between investment income and borrowing rates remain. Should these conditions change the Council may need to borrow at higher rates which would increase revenue costs.

5.3.2 There is continued uncertainty regarding Brexit negotiations and the possibility of a “no deal” exit. SBC’s approach to Brexit is that it is treated as a business continuity issue with appropriate cross-checking carried out with other members of the Hertfordshire Resilience Forum.

5.4 Equalities and Diversity Implications

5.4.1 This purpose of this report is to review the implementation of the Treasury management policy in 2018/19. Before investments are placed with counter parties the Council has the discretion not to invest with counter parties where there are concerns over sovereign nations’ human rights issues.

5.4.2 The Treasury Management Policy does not have the potential to discriminate against people on grounds of age; disability; gender; ethnicity; sexual orientation; religion/belief; or by way of financial exclusion. As such a detailed Equality Impact Assessment has not been undertaken.

BACKGROUND DOCUMENTS

BD1 Prudential Code Indicators and Treasury Management Strategy 2018/19 (28 February 2018 Council)

BD2 Annual Treasury Management Review of 2018/19 (28 February 2018 Council)

6 APPENDICES

- Appendix A – Prudential Indicators for Mid Year Review.
- Appendix B – Investment and Loan Portfolios
- Appendix C – Specified & Non-Specified Investment Criteria
- Appendix D – Approved Countries for Investments