Stevenage BOROUGH COUNCIL

Part I – Release to Press

Meeting:	**Audit Committee / Executive / Council**	**Agenda Item:**
Portfolio Area:	Resources	
Date:	**8 November / 28 November / 6 December 2017**	

2017/18 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 2017/18 and review effectiveness of the 2017/18 Treasury Management and Investment Strategy including the 2017/18 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 2017/18 Treasury Management Mid Year 2017/18 review.

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

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 2017/18 prudential and treasury indicators. This report meets the requirements of both the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management ((revised 2013) (the Code)) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

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 2017)
- Annual Treasury Management Review after the year end (2016/17 was reported to Council 11 October 2017)

3.3 This report summarises:

- Capital expenditure for 2017/18;
- 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 activity; and
- Detailed investment activity.

4. REASONS FOR RECOMMENDED COURSE OF ACTION AND OTHER OPTIONS

4.1 The Council's Capital Expenditure and Financing 2017/18

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 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 2017/18 were originally approved by Council on the 28 February 2017. Since then, capital budget changes have been approved and the Prudential Indicators updated in the 2016/17 Annual Treasury Management Review (approved by Council on the 11 October 2017). The Treasury Management Mid-Year Review Indicators have been updated based on the 1st quarter capital programme reported to Executive (19 September 2017).

4.1.3 Table One (shown below) shows the original capital programme, the revised capital programme (approval Executive 19 September) and financing.

[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.

Table One: 2017/18 Capital Expenditure and Financing		
	2017/18 Original Estimate £'000	2017/18 Revised Mid-Year Review* (Executive September 2017) £'000
Capital Expenditure:		
General Fund Capital Expenditure	7,799	25,993
HRA Capital Expenditure	16,335	17,301
Total Capital Expenditure	**24,134**	**43,294**
• Capital Receipts	(8,112)	(12,595)
• Capital Grants / Contributions	(1,032)	(1,347)
• Capital Reserves	(1,324)	(1,942)
• Revenue contributions	(114)	(110)
• Major Repairs Reserve	(9,683)	(8,430)
Total Resources Available	**(20,264)**	**(24,424)**
Capital Expenditure Requiring Borrowing	**(3,870)**	**(18,870)**

* updated for Property Investment strategy

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). It represents the amount of debt the Council needs to/has taken to fund the capital programme after repayments and Minimum Revenue Provision (MRP) are taken into account.

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

4.2.3 The Council has not undertaken any new physical borrowing as at 8th November 2017.

4.2.4 In 2017/18 the average cash holding between April and September was £70.7Million (£59.3Million April to September 2016/17). 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.

4.2.5 As at the 30 September 2017 the Council had total external borrowing of £209,362,368, (projected to increase to £223,989,789 by 31 March 2018 if all approved borrowing is taken). When expenditure is incurred on the purchase of commercial property the decision to take out the approved borrowing (£15million) will be reviewed. The General Fund has £2,947,368 external borrowing of which £1,500,000 with a local authority and the remainder with the PWLB. The HRA had external borrowing of £206,415,000 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. The remaining difference between the HRA debt portfolio and CFR at 31 March 2018 of is the result of asset transfers from General Fund to the HRA and HRA internal borrowing prior to self-financing.

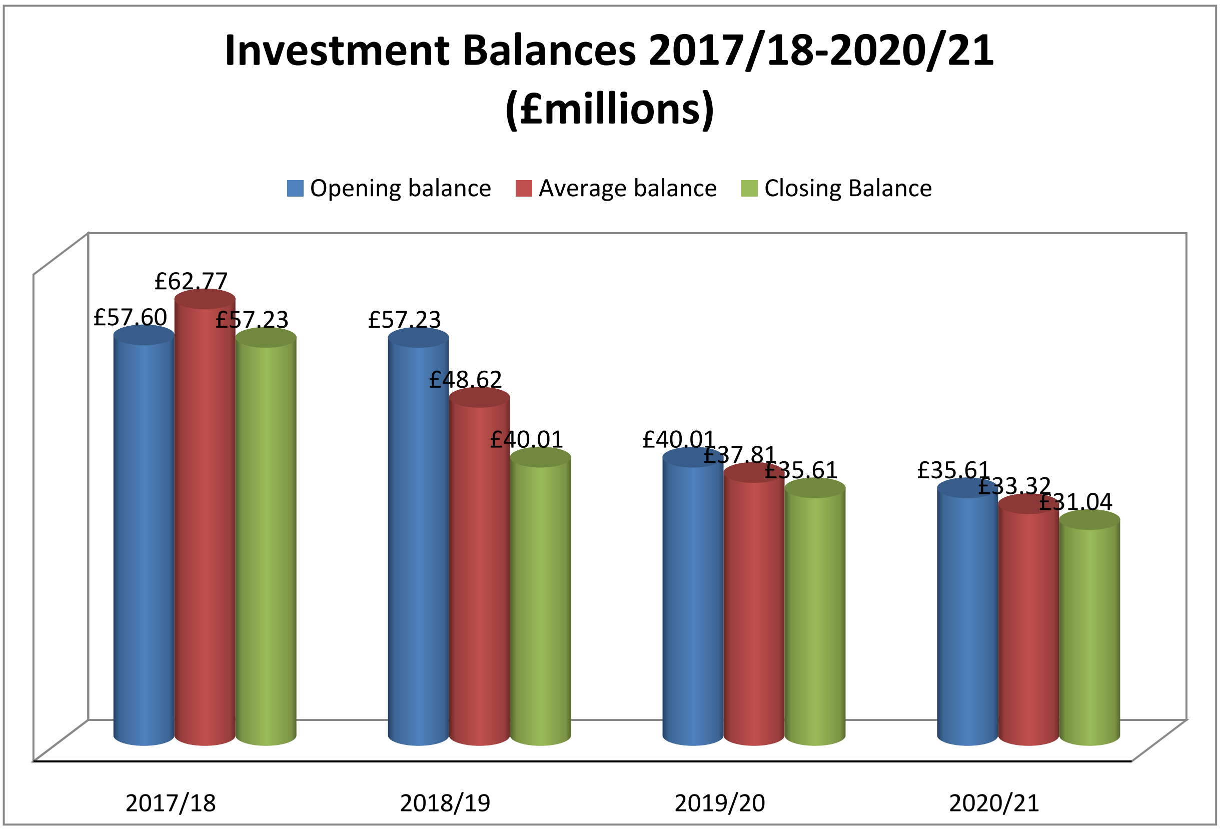
4.2.6 The HRA borrowing includes £11,504,000 used to fund the pre 2012 decent homes programme. This debt was called 'supported borrowing' under the former HRA subsidy system but now forms part of the HRA debt portfolio.

4.2.7 HRA borrowing is constrained by legislation (unlike the General Fund) and is capped at £217,685,000. As at the 31 March 2018 the "head room" available for new HRA borrowing is forecast to be £9,420,078.

4.3 Cash balances and cash flow management

4.3.1 Currently cash balances are estimated to be £57.2Million by 31 March 2018 but is dependent on current spending projections and approved borrowing included in the capital strategy and HRA business plan (General Fund - £15.37million and HRA - £3.5Million) for 2017/18. 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 in included in this report. During the year to 9 November 2017, 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 are shown in Appendix 1.

4.4.2 **Borrowing and the 2016/17 Capital Financing Requirement (CFR)** - The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). It represents the amount of debt the Council needs to/has taken to fund the capital programme after repayments and Minimum Revenue Provision (MRP) are taken into account.

4.4.2 The Council's original estimate and latest CFR for the year is shown below. The estimate of the CFR for 2017/18 has been updated for the Prudential borrowing approved as part of the property investment strategy (Council 17 May 2017).

Table Two : Capital Financing Requirement 2017/18			
CFR Calculation	**2017/18 Original Estimate £'000**	**2017/18 Revised Annual Treasury Management Review of 2016/17 (Approved Council October 2016) £'000**	**2017/18 Revised Mid-Year Review (Executive November 2016) £'000**
Opening Balance	**223,929**	**223,929**	**223,929**
Closing Capital Financing Requirement (General Fund)	14,889	14,889	29,485
Closing Capital Financing Requirement (Housing Revenue Account)	208,386	208,386	208,265
Closing Balance	**223,275**	**223,275**	**237,750**
Increase/ (Decrease)	**(654)**	**(654)**	**13,821**

4.4.3 Total debt repayments made in the first half of 2016/17 relating to principle on PWLB loans were £131,579 (paid in August). A further repayment of £131,579 will be made in February 2017 in relation to General Fund debt and a repayment of £3,741,000 in respect of HRA debt in March 2018.

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 or HRA.

4.4.5 The **net borrowing position** of the Council at 31 March 2018 is estimated to be **£163,386K** of borrowing (total borrowings/loans of £220,619K less total investments held of £57,233K).

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 2017/18. Both limits have been updated to reflect approved borrowing for the HRA and debt cap and approved prudential borrowing for the General Fund.

4.4.7 **Minimum Revenue Provision** (MRP)[2] – In 2017/18 the MRP charged to the General Fund is £653,630, based on previous years' borrowing. At present the only borrowing included in the five year capital programme relates to the ten year plan for the garages estate (£6.7million prudential borrowing over the period 2017/18 to 2020/21) and the investment property strategy (£15million in 2017/18). 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 2017/18 this indicator remains unchanged. 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 2017/18 onwards have been calculated based on the 1st quarter capital programme reported to Executive 11 September 2016. There will subsequent updates to the capital programme including the capital bidding process for the period 2018/19 to 2021/22 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.

4.5 Update on Treasury Management Strategy Position 2017/18

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

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[2] 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.

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 0.5% (see also para 4.8.3) and the risk appetite in the treasury management strategy. As at 30 September 2017 the 2017/18 average rate of interest being earned on investments was 0.54% this compares to 0.57% earned in 2016/17. This exceeded the 7 day LIBID benchmark rate of 0.11% (source: CAPITA 30-9-17).

4.5.3 While costs for loans of between eight and ten years are around 2.02-2.24% (as at 26 October 2017) it is still prudent to utilise the Council's cash balances (as shown in paragraph 4.3.3) 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 Four Treasury Position 2017/18

	30 Sep 2017 Principal £'000s	**Rate / Return %**	**Average Life (Yrs)**	**31 Mar 2018 Principal £'000s**	**Rate / Return %**	**Average Life (Yrs)**
Fixed rate loans - PWLB	207,862	3.38	16.65	203,990	3.38	16.09
Local Authority Loans	1,500	1.98	1.00	1,500	1.98	0.25
Approved Prudential Borrowing				15,370	Yet to be taken	Yet to be taken
Approved HRA Borrowing				3,500	Yet to be taken	Yet to be taken
Total Borrowing	**209,362**	**3.38**	**16.66**	**224,360**	**3.38**	**16.09**
CFR				237,750		
Over/(under) borrowing*				13,390		
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 Six Maturity of Debt Portfolio for 2016/17 and 2017/18		
Time to maturity	**31 March 2017 Actual £'000's**	**30 September 2017 Actual £'000's**
Maturing within one year	4,004	5,504
1 year or more and less than 2 years	1,763	263
2 years or more and less than 5 years	790	789
5 years or more and less than 10 years	8,763	8,632
10 years or more	194,174	194,174
Total	**209,494**	**209,362**

4.5.6 There are five investments with **maturities over one year**: £3Million with Birmingham CC (maturing April 2019), £1.3Million with Spelthorne BC (maturing June 2019), £2Million with LB Barking & Dagenham (maturing April 2020), £1Million with Newcastle CC (maturing April 2020) and £2.7Million with Barnsley MBC (maturing September 2021) . All other investments held during the first half of 2017/18 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 Seven. (See also Appendix B).

Table Seven : Fixed and Variable Rate Investment Totals		
	31 March 2017 Actual £'000's	**30 September 2017 Actual £'000's**
Fixed rate principal	35,295	50,100
Variable rate principal	22,300	19,350
Total	**57,595**	**69,450**

4.5.7 Included in the 2017/18 Treasury Management strategy was an increase in the treasury limit for "**fixed rate more than 12 months to maturity**" when balances are in excess of £30million (Recommendation 2.3 Treasury Management Review including Prudential Code – Council 28 Feb 2017). Since implementation £10Million is held in deposits of 12 month plus duration. As part of the mid-year review no changes are proposed to the current treasury limits. Since the instant access limit was removed in the last treasury management policy update there have been no instances where short term borrowing has been required to address short term cash flow difficulties.

4.5.8 The total limit on the amount invested in **Money Market Funds** was revised (Recommendation 2.5 Treasury Management Review including Prudential Code – Council 28 Feb 2017) and since then a third Money Market fund has been added to the portfolio – Amundi.

4.5.9 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.

4.5.10 The use of **enhanced cash funds** was also approved in February. 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). Officers are liaising with the Council's treasury management advisors to find a suitable USDB funds that meet the Council's investment timescales and risk criteria. Currently no investments have been made with USDB funds.

4.5.11 The latest list of "Approved Countries for Investments" has been updated and is detailed in Appendix D.

4.5.12 Following the approval of the Property Investment Strategy (Council 17th May 2017) the **Operational Boundary and Authorised Limit** for the General Fund was increased by £15Million to facilitate the borrowing required for the strategy. Further changes to these limits are not required at present.

4.5.13 **Other Treasury Management Issues** - 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. Stevenage Borough Council is required to complete forms sent by each institution dealing with this SBC and for each type of investment instrument we use, apart from cash deposits with banks and building societies. Officers are liaising with the council's advisers, Capita, to ensure all paperwork is in place before 3 January 2018.

4.6 Economic Review & Interest Rate Outlook

4.6.1 In March 2017 the Prime Minister triggered Article 50 of the Lisbon Treaty, the formal process to leave the EU. This is thought to have contributed to a further decline in the value of sterling contributing to inflationary pressures.

4.6.2 **Inflation -** The Bank of England inflation reports during 2017 expected that Consumer Price Index (CPI) inflation would peak at just under 3% in 2017 before falling back nearer to its target rate of 2% in two years' time. Inflation (CPI) was 3.0% in September, and at the 14 September Monetary Policy Committee (MPC) meeting the forecast was revised to peak at over 3%. CPI rates for 2017/18 are shown in the following table.

	April 2017	May 2017	June 2017	July 2017	August 2017	September 2017
CPI Rate	2.7%	2.9%	2.6%	2.6%	2.9%	3.0%

4.6.3 **Interest Rate** – The MPC warned markets and forecasters that the Bank Rate will need to rise in light of inflation pressures and other economic data. On 2 November the MPC increased the Bank Rate to 0.5% as anticipated. Currently short sterling rates are indicating that financial markets do not expect a second increase until May 2018 with a third increase in November 2019. Any medium term interest forecast are caveated due to continuing uncertainty around the Brexit negotiations, consumer and business confidence. Should interest rates increase by 0.25% annual interest costs would rise by £2,500 for every £1million of new borrowing taken.

4.6.4 **UK Growth** – Following strong growth in 2016, the UK economy slowed in the in the first (+0.3%) and second quarter at (+0.3%) which meant that growth in the first half of 2017 was the slowest since 2012. The main reason for this has been the sharp increase in inflation (see para 4.8.1) and resulting reduction in consumer disposable income and spending power. The services sector of the economy (around 75% of GDP), has seen weak growth as consumers cut back on their expenditure. However, more recently there has been strong growth in the manufacturing sector (11% of GDP) as a weaker pound generates increased demand for exports. It has helped that growth in the EU, the UK's main trading partner, has improved significantly over the last year.

4.6.5 **Wage inflation** – Unemployment has fallen to 4.3%, the lowest level since 1975, however improvements in productivity have been weak. Whole-economy average weekly earnings (AWE) increased by 2.2% in the three months to August 2017, compared with the same period a year ago. The MPC now has a more tolerant view of low wage inflation as this now seems to be a common factor in nearly all western economies as a result of increasing globalisation. This effectively means that the UK labour force faces competition from overseas labour depressing the negotiating power of UK labour.

5. IMPLICATIONS

5.1 Financial Implications

5.1.1 This report is of a financial nature and reviews the treasury management function for the 2017/18. Any consequential financial impacts of the Strategy will be incorporated into November Capital Strategy update and the 2nd Quarter 2017/18 budget monitoring report.

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.

5.4 Equalities and Diversity Implications

5.4.1 This purpose of this report is to review the implementation of the Treasury management policy in 2016/17. 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 2017/18 (28 February 2017 Council)
http://www.stevenage.gov.uk/content/committees/160923/160927/160991/20170228-Item12.pdf
BD2 Annual Treasury Management Review of 2016/17
http://www.stevenage.gov.uk/content/committees/182083/182095/182099/Council-11-October-2017-Item11.pdf

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