APPENDIX A - Treasury Management Mid-Year Report

1 INTRODUCTION

1.1 Background to Treasury Management

1.1.1 The Council is required to operate a balanced budget, which means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed to meet day-to-day running costs and planned capital expenditure. Any surplus monies are invested in counterparties or instruments commensurate with the Council's risk appetite, providing adequate liquidity initially before considering investment return.

1.1.2 The second main function of the treasury management service is the funding of the Council's capital plans as set out in the Budget and Capital Investment Strategy (CIS). These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning, to ensure that the Council can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans, or using longer-term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.

1.1.3 CIPFA defines treasury management 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."

1.2 What framework or rules do we need to follow?

1.2.1 As local authorities have seen a significant drop in local government funding, there has been increased investments in assets – often outside the local authority area – in a bid to generate revenue and balance the books.

1.2.2 Some of the deals that local authorities have entered into, often funded by significant borrowing, have raised concerns with the property deals being much bigger than core Council business such that a crash in property markets could effectively render some Council's 'bankrupt'.

1.2.3 On the back of this activity, updated guidance was produced:

- Prudential Code for Capital Finance in Local Authorities (2011) (Prudential Code) - this has been updated and introduces a formal requirement for a capital strategy to be approved by Council including "the authority's approach to investments and commercial activities including processes, due diligence and defining the authorities risk appetite in respect of these including proportionality in respect of overall resources".

- Treasury Management: Code of Practice and Cross-Sectoral Guidance Notes (Treasury Management Code) - this has been updated and again requires more explicit reference to how non treasury investments are managed – "It is critical that due diligence processes and procedures reflect the additional risk an organisation is taking on. Due diligence procedures should ensure effective scrutiny of proposed investments, identification of risk to both capital and returns, any external underwriting of those risks, and the potential impact on the financial sustainability of the organisation if those risks come to pass".

- Minimum Revenue Provision - Guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003. This prevents various practices such as spreading the MRP charge over a period longer than 50 years or making retrospective changes which give rise to a credit – "Changing the method used to calculate MRP can never give rise to an overpayment, and should not result in a LA making a charge of £nil for the accounting period in which the change is made".

- Guidance on Local Authority investments - Issued under section 15(1)(a) of the Local Government Act 2003. This guidance is consistent with the Codes described above.

1.2.4 The Council approved a Strategy in February 2018 (report 06/2018) which covered:

- The Capital Prudential Indications
- Borrowing Starategy
- Annual Investment Strategy and Commerical Investment Policy
- The Treasury Prudential Indicators and MRP Statement

1.2.5 The TMS allows for treasury investment in property funds, corporate bonds alongside short term deposits. The Council developed a Commercial Investment Policy that allows for capital investments in property etc that yield a positive net return for the Revenue Account to help subsidise the provision of other Council services, this was included as part of the Capital Investment Strategy.

2 THE CAPITAL PRUDENTIAL INDICATORS 2018/19

2.1 Capital Expenditure

2.1.1 The Council's capital expenditure plans as set out in the budget are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

2.1.2 The capital expenditure prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. As at 30 September 2018 the Council estimates that it will have capital projects approved of £28.252m. The details of this are shown in Quarter 2 Financial Management Report (Report No: 193/2018)

2.1.3 The Council's forecast capital expenditure for 2018/19 is £28.3m. The Quarter 2 report (193/2018) contains detailed analysis of the revised capital programme and financing. The £28.3m was financed as per the table below. The financing need represents an increase in borrowing requirements.

	2018/19 Treasury Strategy Estimate*	2018/19 Original Estimate **	2018/19 Revised Estimate
	£000	£000	£000
Capital Expenditure	**14,252**	**22,763**	**23,223**
Financed by:			
Capital Receipts	504	1,474	1,488
Capital Grants & Contributions	2,148	8,360	9,098
Revenue	0	0	25
Total Financing	**2,652**	**9,834**	**10,611**
Net financing need for the year	**11,600**	**12,929**	**12,612**

* The Treasury Management Strategy report was presented to Cabinet on 16 January 2018, before the Capital Programme was approved.
** The 2017/18 Outturn Report 83/2018 updated the Capital Programme with 2018/19 carry forwards and additional capital schemes.

2.2 The Council's Borrowing Need (the Capital Financing Requirement)

2.2.1 The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's indebtedness and its underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

2.2.2 The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the indebtedness in line with each assets life, and so charges the economic consumption of capital assets as they are used.

2.2.3 The Council's CFR forecast for 2018/19 is shown below, and represents a key prudential indicator.

	2017/18 Actual	2018/19 Treasury Strategy Estimate	2018/19 Revised Estimate
	£000	£000	£000
CFR – 1 April	**22,756**	**22,040**	**21,858**
Movement in Year -			

Net financing need for the year (from table at para 3.2.1)	0	11,600	12,612
MRP	(897)	(629)	(614)
Total Movement in Year	(897)	10,971	11,998
CFR – 31 March	**21,858**	**33,011**	**33,856**

3 BORROWING

3.1 Borrowing objectives

3.1.1 Councils borrow to fund capital expenditure or refinance/reschedule existing borrowing e.g. replace one loan with one at a lower rate. There are 7 types of borrowing outlined in the strategy.

3.1.2 Effectively, the Council works out its capital expenditure plans and then calculates how much it needs to borrow having considered whether it should fund capital expenditure using other options. The Council's objectives are to:

- avoid external borrowing as far as possible (i.e. use other sources of funding first where possible) unless that borrowing yields income or deliver savings beyond the cost of borrowing;
- repay borrowing early if this is financially prudent and viable;
- reduce its borrowing charge if this represents value for money;
- ensure any new borrowing is affordable; and
- work within prudential indicator limits.

3.2 Current borrowing portfolio

3.2.1 The Council currently has loans outstanding of £22.436m of which £21.386m are long term loans with the Public Works Loans Board (PWLB). PWLB is managed as part of the UK Debt Management Office, which is a HM Treasury Executive Agency. The remainder is a £630k Local Enterprise Partnership interest free loan which matures in 2023, and an interest free Salix loan of £420k repayable in 2020. Included within the £21.386m is £8.232m of debt that was inherited from Leicestershire in the Local Government Re-organisation in 1997.

3.2.2 No additional borrowing has been undertaken so far in 2018/19. The last time the Council actually borrowed from the PWLB was in 2008 to contribute towards funding the Oakham bypass, the value of this loan was £4m.

3.2.3 All PWLB loans have been borrowed on a maturity basis. Interest payments will be made every six months on equal instalments throughout the term of the loan, with the principal being re-paid on the maturity date.

3.2.4 The table below shows the actual external debt against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing. A key prudential indicator is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR.

	2017/18 Actual £000	**2018/19 Revised Estimate £000**	**2019/20 Estimate £000**	**2020/21 Estimate £000**
Gross Debt	22,436	27,436	27,436	27,436
Capital Financing Requirement (CFR)	21,859	33,856	33,192	32,528
Under / (Over) borrowing	(577)*	6,420	5,756	5,092

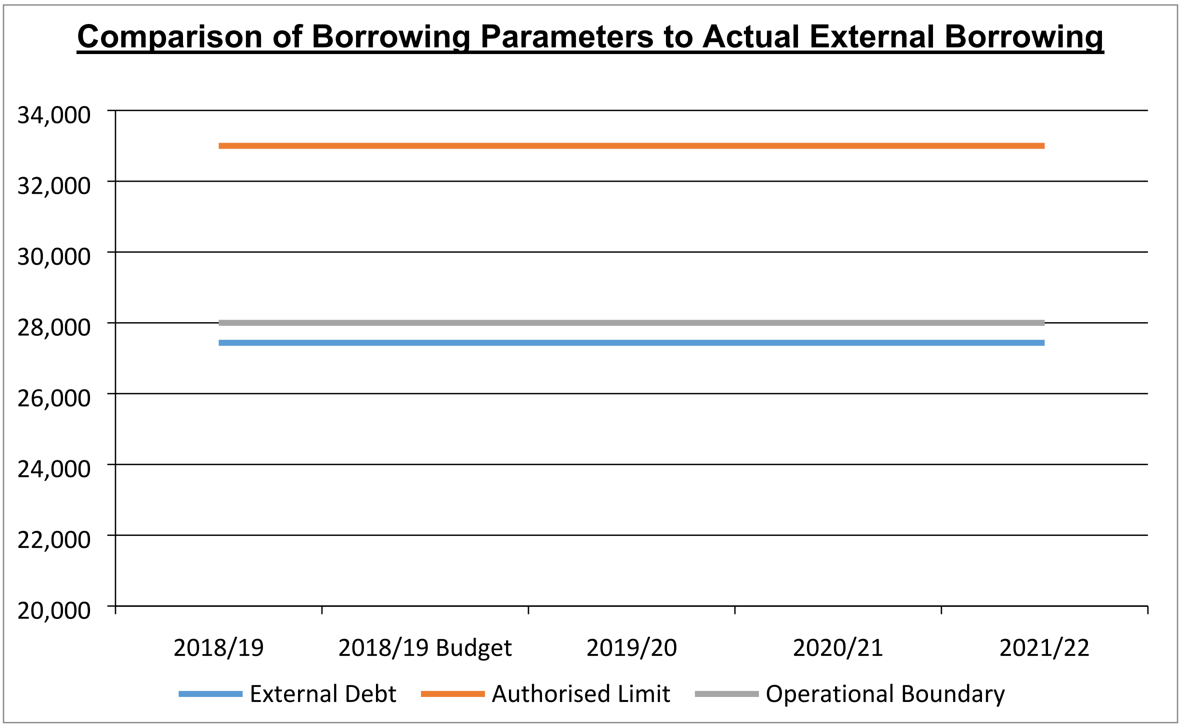
*Under Borrowing Position explained in Treasury Management Strategy 2017/18 (41/2017)

3.3 Treasury Indicators: Limits to Borrowing Activity

3.3.1 ***The operational boundary*** - This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources.

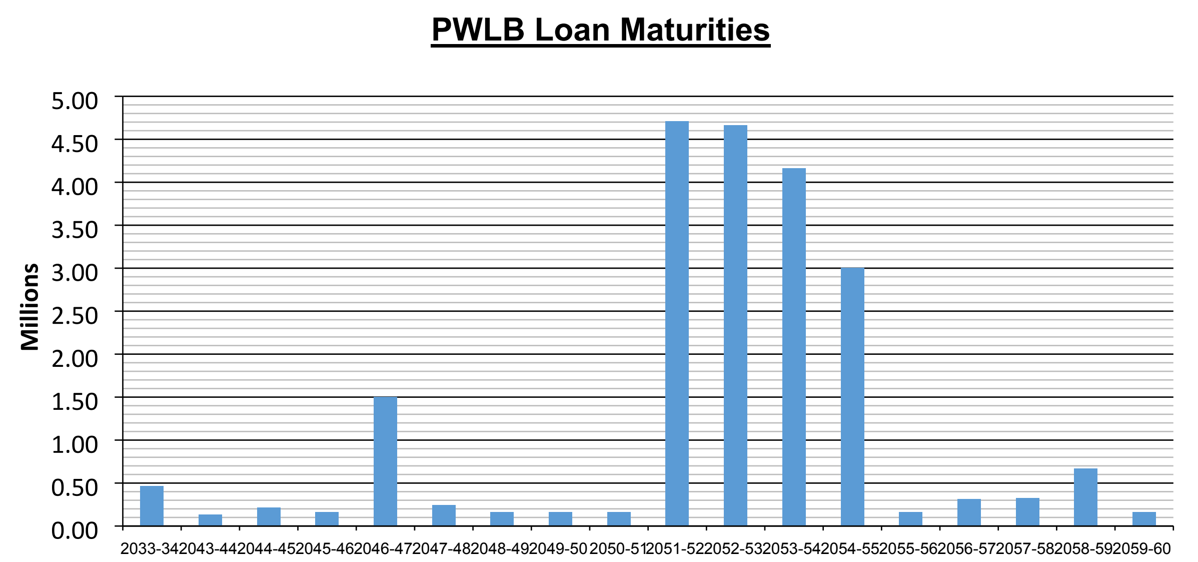
3.3.2 ***The authorised limit for external debt***. A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

3.3.3 The graph below shows where we currently are against all of the borrowing prudential indicators.



3.4 Debt Repayment and rescheduling

3.4.1 The table below demonstrates when PWLB debt is due to be repaid.



3.4.2 The latest advice from Link, the Council's Treasury Management Advisors, indicates that the premium at 30 September 2018 was £15.43m. This would mean it would cost £15.43m in addition to the £21.386m principal totalling £36.82m, in order to repay the Council's PWLB loans.

4 INVESTMENT STRATEGY REVIEW

4.1 Investment overview

4.1.1 The Council receives substantial income from council tax, business rates and central government. The majority of council tax and business rates payments are received between April and January, with expenditure being fairly static throughout the year.

4.1.2 During the first half year investments have ranged from £24.6m to £31.0m. The table below shows the level of investments held at 30 September 2018 and the forecasted balances to the end of the Financial Year.

	Investments 31-Mar-18 £000	**Investments 30-Sep-18** £000	**Forecast Investments 31-Mar-19** £000
UK Banks *(f)*	15,001	14,603	15,000
UK Building Societies *(f)*	10,000	10,000	2,000
UK Local Authorities	0	10,000	10,000
UK Call Accounts *(v)*	5,000	0	0

Total Fixed Interest Rates *(f)*	**25,001**	**34,603**	**27,000**
Total Variable Interest Rates *(v)*	**5,000**	**0**	**0**
Total Investments	**30,001**	**34,603**	**27,000**

4.1.3 Most of the Councils investments are made at fixed interest rates over 6 -12 months. For cash flow purposes, some funds are held in instant access accounts.

4.1.4 The revised budget position for investment income is:

	Original Estimate 2018/19 £000	**Received to 30-Sep-18** £000	**Revised Estimate 2018/19** £000
Investment Income	194	124	224
Other Interest Received *	16	16	16
Total	210	140	240

* The Council also receives interest from sources other than investments. A Housing Association has been recharged £12k for the principal and interest of loans that the Council has made to it, the final payment will be in 2051/52. In 2018/19 £4k was received from the sale of buses.

4.2 Investment rules

4.2.1 Like us as individuals, the Council will invest surplus money in various ways to get a return on balances thus generating extra income. As per our overall objectives, we ensure that these surplus balances are managed in a way to maximise the income potential whilst having regard to security risk.

4.2.2 The Council's investment strategy primary objectives, in order of importance are:

- safeguarding the re-payment of the principal and interest of its investments on time – losing any funds like in the case of Icelandic banks would be very significant in this financial climate;
- ensuring adequate liquidity – the Council does not want to run short of money so it cannot pay its bills or does not have money available to make investments in capital expenditure;
- maximising the investment return – this is clearly important but the Council does not want to maximise returns at the expense of the first two objectives.

4.2.3 The Council has only invested in agreed specified and non-specified investments listed in Appendix 1, paras 4.4.5 of the Treasury Management Strategy. The current investment counterparty criteria selection approved in the Treasury Management Strategy Statement is meeting the requirement of the treasury management function.

4.3 Investment Performance

4.3.1 The Code of Practice on Treasury Management requires the Council to set performance indicators to assess the adequacy of the treasury function over the year. An example of a performance indicator often used for the investment treasury function is internal returns above the 6 month LIBOR rate (the average interbank interest rate at which a selection of banks on the London money market are prepared to lend to one another). The Council monitored performance against the LIBOR rate for the first six months of 2018/19 and the results are shown below.

	2017/18	**2018/19 (Q1)**	**2018/19 (Q2) (Cumulative)**
RCC Returns (%)	0.66	0.70	0.75
LIBOR (%)	0.49	0.78	0.90

4.3.2 Although the achieved rate is above what we achieved last year, the rate is below LIBOR. All information suggested a rate rise was expected in November however if the Council had invested on a short term basis (i.e. less than one year), it would have achieved a lower rate of return. Importantly, the Council did hold some shorter term investments (which achieve lower returns) so that it could respond should a Commercial investment opportunity have materialised. The Council is outperforming budget by c£30k with the rate of return in line with other council's performance.

4.4 Affordability Prudential Indicators

4.4.1 The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following indicators:

4.4.2 **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.

	Original Estimate 2018/19 £000	**Forecast Quarter 2 2018/19 £000**

Financing Costs		
Capital Financing Costs	1.647	1.647
Interest Receivable	(0.210)	(0.250)
A	1.437	1.397
Revenue Stream		
Government Grants	4.779	5.047
Retained Business Rates	4.963	4.763
Council Tax	24.870	24.870
B	34.612	34.680
Ratio (A divided by B as a percentage)	4.15%	4.03%

4.4.3 The estimates of financing costs include current commitments and the proposals in the budget report.

5 CAPITAL INVESTMENT STRATEGY

5.1.1 Continued reductions in Government funding and reduced investment income from traditional Treasury Management investments are still anticipated reinforcing the need for the Council to maximise income from other sources. In its efficiency plan (Report 151/2016) approved by Council in September 2016, the Council noted that one of its strategies for reducing the gap in the MTFP was to make better use of assets/capital resources: "The Council recognises that investing in new assets or enhancing/making better use of existing assets can have a beneficial impact in terms of a revenue payback or reducing revenue costs. Officers have been asked to bring forward proposals to be considered"

5.1.2 The Capital Investment Strategy published alongside the TMS identified the key principles of:

- Focus capital investment on delivery of council objectives and priorities
- Maximise and promote best use of available funds
- Ensure strong governance over decision-making
- Ensure plans are affordable, prudent and sustainable

5.1.3 Commercial investments are made in accordance with the Commercial Investment Policy which details the criteria and minimum requirements for appraising potential investments.

5.1.4 During the first 6 months of 2018-19 no commercial investments have been identified.