Worcester CITY COUNCIL

Report to: Policy and Resources Committee, 30th July 2018

Report of: Head of Finance

Subject: TREASURY MANAGEMENT ANNUAL REPORT – 2017/18

1. Recommendation

1.1 **That Policy and Resources Committee note the details included within the Treasury Management Annual Report for 2017/18; and**

1.2 **That the Treasury Management Annual Report for 2017/18 is referred to full Council for information, in accordance with the CIPFA Treasury Management Code.**

2. Background

2.1 In February 2010 the Council formally adopted the principles and practices from the CIPFA Code of Practice on Treasury Management, including clause 2 which stated:

"the production of regular treasury management reports to Council, including as a minimum, an annual strategy, prudential indicators and limits and MRP policy in advance of the year, a mid-year review, and an annual review report after the close of the year, all in the form specified in the Treasury Management Practices."

2.2 This report sets out, in accordance with the above, a report on Treasury Management performance for 2017/18.

2.3 Treasury Management is the management of all money and capital market transactions in connection with cash and funding resources of the Council. The Council conducted its Treasury Management affairs in accordance with the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities.

2.4 A copy of the Treasury Management Policy Statement and the Annual Strategy Statement can be obtained from the Head of Finance.

3. The Council's Treasury Management Performance in 2017/18

INVESTMENTS

3.1 The Council manages its investments in-house and invests with the institutions listed in the Council's approved lending list. The Council invests for a range of periods from overnight to 365 days, dependent on the Council's cash flows, its interest rate view and the interest rates on offer.

3.2 The Council currently invests in four types of instrument - Fixed Term Deposits, Instant Access Deposits, Certificates of Deposit and Money Market Funds. On advice from our treasury advisors we do not currently invest with Building Societies. The Council plans to invest mainly in Money Market Funds and with other Local Authorities during 2018/19 as these both offer high levels of security and provide competitive rates of return. The Council also intends to diversify its investment portfolio by placing a longer-term investment with the CCLA Property Fund.

3.3 The Council's average investment for the year was £1.87m (2016/17: £1.62m). The running return earned at the year end was 0.54% (2016/17: 0.57%) which is in excess of the bank base rate of 0.50% and approximately 0.14% above the benchmark average 3 month LIBOR (London Inter Bank Offer Rate) for the year.

3.4 The Council achieved £87,280 of interest from its cash investments in 2017/18 (2016/17: £127,960). This was £4,870 more than the budgeted target of £82,410.

3.5 It should be noted that the return on investments has now been severely suppressed for the past ten years. For comparison in 2007/08 the interest rate was in excess of 5% and the interest earned was £727,000. This is in main due to the economic crash of 2008/09 and the continuing effect of the government scheme called 'Funding for Lending' launched in July 2012. This caused a flood of cheap credit to be made available to banks which then resulted in investment rates falling further. These rates continued at very low levels during 2017/18 as banks continued to strengthen their balance sheet positions in response to the European banking regulation Basel III causing their appetite for cash to reduce. Further background on the economic conditions in 2017/18 is contained in **Appendix 1**.

3.6 **Tables 1, 2, 3 and 4** below, provide further details on our monthly investments and our lending investment portfolio as at 31st March 2018.

Table 1: Summary of Interest Received 2017/18

	Interest Received £
Interest received in year (cash)	**72,231**
Interest to be received in 18/19 relating to 17/18	**15,049**
Interest received – reported in accounts 17/18	**87,280**
Budget 17/18	**82,410**

Table 2: Investment Balances 2017/18

	Investment Balances £m
Investment balances as at 1st April 2017	**14.5**
Total of all periodic investments made in year	**43.1**
Total of all investments matured in year	**(46.8)**
Investment balances as at 31st March 2018	**10.8**

Table 3: External Lending Investment Portfolio (position as at 31 March 2018)

Borrower	Issue Date	Maturity Date	Investment £m	Interest Rate
Standard Chartered	04/10/17	04/04/18	1.5	0.41%
Santander UK	12/01/18	13/04/18	2.2	0.40%
Federated MMF	06/03/18	30/04/18	1.2	0.45%
Blackrock MMF	19/01/18	21/05/18	1.4	0.39%
CCLA MMF	28/03/18	22/05/18	2.0	0.46%
Bank of Scotland	04/10/17	24/09/18	2.5	0.75%
Total			**10.8**	

Table 4: Investment Limits

	2017/18 Max. amount placed per Institute	31.03.18 Actual per Institute	2017/18 Limit per Institute	Complied
DMO or UK Treasury Bills	Not used	Nil	No limit	√
Corporate Bonds	Not used	Nil	£4m	√
UK Local Authority	£3m	Nil	£4m	√
Term Deposits with Banks	£2.6m	£2.5m	£4m	√
Certificates of Deposit with Banks	£2m	£1.5m	£4m	√
Call and Notice Accounts with Banks	£2.2m	£2.2m	£4m	√
Banks nationalised or part-nationalised by UK Government	Not used	Nil	£4m	√
Floating Rates Notes with Banks	Not used	Nil	£4m	√
Money Market Funds	£2.4m	£1.2m, £1.4m & £2m	£4m	√

EXTERNAL BORROWING

3.7 As at 31st March 2018 the Council's loans are a £5m Lender Option Borrower Option (LOBO) loan and £2.334m of Public Works Loans Board (PWLB) loans. The LOBO was taken on for a period of 50 years from the 3rd December 2004.

3.8 The Council has approved a strategy for the replacement of the LOBO loan in the event that the lender exercises their option and increases the interest rate. The agreed action, in this event, is to replace the loan with a shorter dated loan and keep the rate as low as possible bearing in mind the Financing Requirement contained in the Council's Treasury Management Strategy (Prudential Borrowing Limits).

3.9 The interest payable in 2017/18 on existing loans was £359k (2016/17: £363k). This slight decrease was due to the maturity of three PWLB loans part way through the year. The lender of our £5m LOBO loan did not exercise their right to increase the rate from the current 4.50% at any point during the year and the likelihood of this occurring remains extremely low in the current interest rate environment.

3.10 The Council did not raise any new external borrowing during 2017/18. The Council's approval for the building of Perdiswell Swimming Pool was for funding of £10.4m which included borrowing of £4.6m. To date the Council's financial position has not necessitated taking this borrowing out. This is the most prudent approach and the Council will only consider externally borrowing and incurring interest costs where appropriate.

3.11 The long-term interest rates on offer are closely monitored and are currently showing no sign of increasing significantly. Should this situation change, the approved borrowing may be enacted to ensure the Council secures borrowing at a competitive rate.

4. Treasury Management Performance Indicators

4.1 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. These are distinct historic indicators, as opposed to the prudential indicators, which are predominantly forward looking.

4.2 Performance on our key Treasury Management Performance Indicators for 2017/18 is as follows:

Performance Indicator	Benchmark/ Budget	Outturn
Average rate of return on investments	0.50% in MTFF	0.54%
Investment management costs per average sum invested	£1.06 per £'000	£1.06 per £'000
Annual cost of borrowing (including minimum revenue provision)	£1,046,300	£831,102
FTE staff involved in Treasury Management function	0.48 FTE	0.48 FTE

5. Prudential Indicators

5.1 The purpose of the indicators is to provide a framework to support decision making on capital expenditure and treasury investments. The indicators highlight the level of capital expenditure, the impact on borrowing, investment levels, and the overall controls in place to ensure the activity remains affordable, prudent and sustainable. Details of the indicators are included below.

Actual and Estimated Capital Expenditure

5.2 The actual and estimated capital expenditure (CapEx) for 2017/18 is as follows:

Actual CapEx 2016/17 £'m	PI CapEx 2017/18 £'m	Actual CapEx 2017/18 £'m
12.266	6.636	3.511

5.3 The original capital programme budget for 2017/18 was £3.121m. However this was adjusted to reflect in-year additions and re-profiled budgets carried forward from 2016/17 to the value of £3.515m. Further detail on capital expenditure is included in the Q4 Financial Monitoring report 2017/18 and the Statement of Accounts 2017/18.

Ratio of Financing Costs to net revenue stream

5.4 The net revenue stream is the amount of the budget to be met from Formula Grant and Council Tax income (also known as the Budget Requirement). Financing cost is the net of interest payable, interest receivable and minimum revenue provision.

	2016/17 Actuals £000's	2017/18 Budget £000's	2017/18 Actuals £000's	2018/19 Budget £000's
Financing costs (net)	616	965	697	604
Net revenue stream	9,637	12,155	11,283	10,812
Ratio of financing costs to net revenue stream	6.39%	7.94%	6.18%	5.59%

Ratio of Financing Costs to gross expenditure

5.5 Gross expenditure is shown to demonstrate the proportion of our financing costs compared to our total expenditure.

	2016/17 Actuals £000's	2017/18 Budget £000's	2017/18 Actuals £000's	2018/19 Budget £000's
Financing costs (net)	616	965	697	604
Gross expenditure	19,842	21,712	21,341	20,912
Ratio of financing costs to gross expenditure	3.10%	4.44%	3.27%	2.89%

Capital Financing Requirement

5.6 The Capital Financing Requirement is a gauge of the Council's requirement to take on long term borrowing for capital purposes. This is calculated from the draft Balance Sheet for 2017/18, which was approved by the Council's Section 151 officer before the deadline date of 31st May 2018, and which is subject to independent audit. The actual Capital Financing Requirement at 31 March 2018 (again subject to audit) and estimates for future years are:

	2016/17 Actuals £000's	2017/18 PI/Budget £000's	2017/18 Actuals £000's	2018/19 Estimate £000's
Capital Financing Requirement	12,881	11,847	11,502	11,196

Minimum Revenue Provision

5.7 The Minimum Revenue Provision (MRP) represents a charge to Council Tax payer's equivalent to the estimated repayment of prudential borrowing associated with the purchase of capital assets (i.e. reducing the loan principal in instalments).

5.8 The MRP charge for 2017/18 was £472k (2016/17: £381k) against a budget of £476k.

Authorised Limit/Operational Limit for External debt

5.9 The Council approved the Authorised Limit in 2017/18 for external debt at £23.0m. The approved Operational Limit was £17.2m. The Operational Limit is calculated on the same basis as the Authorised Limit, but differs in that it excludes short term borrowing.

5.10 The Council's external debt as at 31st March 2018 is £7.334m which is within the limits set in the Treasury Management Strategy.

6. Changes Affecting Treasury Management

6.1 CIPFA published revised editions of the Treasury Management and Prudential Codes in December 2017. The required changes from the 2011 Code are being incorporated into Treasury Management Strategies and monitoring reports.

6.2 The 2017 Prudential Code introduces the requirement for a Capital Strategy which provides a high-level overview of the long-term context of capital expenditure and investment decisions and their associated risks and rewards along with an overview of how risk is managed for future financial sustainability. This is being by officers ready for production in the autumn.

6.3 As a result of the 'Markets in Financial Instruments Directive' (MiFID II), from 3rd January 2018 local authorities were automatically treated as retail clients but could "opt up" to professional client status, providing certain criteria was met which includes having an investment balance of at least £10 million and the person(s) authorised to make investment decisions on behalf of the authority to have at least a year's relevant professional experience.

The Authority has met the conditions to opt up to professional status. The Authority will continue to have access to products including money market funds, pooled funds, treasury bills, bonds, shares and to financial advice.

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Appendix 1

Treasury Management Annual Report
Background information from our Treasury advisors; Arlingclose

Economic Background for 2017/18

I. The financial year was characterised by the push-pull from expectations of tapering of Quantitative Easing (QE) and the potential for increased policy rates in the US and Europe and from geopolitical tensions, which also had an impact. The UK economy showed signs of slowing with latest estimates showing GDP, helped by an improving global economy, grew by 1.8% in calendar year 2017, the same level as in 2016. This was a far better outcome than the majority of forecasts following the EU referendum in June 2016, but it also reflected the international growth momentum generated by the increasingly buoyant US economy and the re-emergence of the Eurozone economies.

II. The inflationary impact of rising import prices, a consequence of the fall in sterling associated with the EU referendum result, resulted in year-on-year CPI rising to 3.1% in November before falling back to 2.7% in February 2018. Consumers felt the squeeze as real average earnings growth (after inflation) turned negative before slowly recovering. The labour market showed resilience as the unemployment rate fell back to 4.3% in January 2018. The inherent weakness in UK business investment was not helped by political uncertainty following the surprise General Election in June and by the lack of clarity on Brexit, the UK and the EU only reaching an agreement in March 2018 on a transition which will now span Q2 2019 to Q4 2020.

III. The Bank of England's Monetary Policy Committee (MPC) increased Bank Rate by 0.25% in November 2017. It was significant in that it was the first rate hike in ten years, although in essence the MPC reversed its August 2016 cut following the referendum result. The February Inflation Report indicated the MPC was keen to return inflation to the 2% target over a more conventional (18-24 month) horizon with gradual and limited policy tightening. Although in March two MPC members voted to increase policy rates immediately and the MPC itself stopped short of committing itself to the timing of the next increase in rates.

IV. The increase in Bank Rate resulted in higher money market rates: 1-month, 3-month and 12-month LIBID rates averaged 0.32%, 0.39% and 0.69% and at 31st March 2018 we 0.43%, 0.72% and 1.12% respectively.

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