REPORT TO:	**General Purposes and Audit Committee** **6 December 2017**
SUBJECT:	**Treasury Management Strategy Statement, Annual Minimum Revenue Provision Policy Statement & Annual Investment Strategy 2017/2018** **Mid-Year Review**
LEAD OFFICER:	**Executive Director of Resources (Section 151 Officer)**
CABINET MEMBER:	**Councillor Simon Hall Cabinet Member for Finance & Treasury**
WARDS:	**All**

CORPORATE PRIORITY/POLICY CONTEXT:
Sound Financial Management. This report details the Council's Treasury Management activities during the first half of 2017/2018 and the Council's compliance with the 2011 Prudential Code for Capital Finance.

FINANCIAL SUMMARY: This report details the Treasury Management activities in the first half of 2017/2018 and demonstrates the Council's compliance with the 2011 Prudential Code for Capital Finance.

FORWARD PLAN KEY DECISION REFERENCE NO.:

For general release

1. RECOMMENDATIONS

1.1. The Committee are asked to note the contents of this report and to:

(a) Endorse the continued implementation of the Council's Treasury Strategy Statement, Annual Minimum Revenue Provision Policy Statement & Annual Investment Strategy 2017/2018 by the Executive Director of Resources (Section 151 Officer).

EXECUTIVE SUMMARY

2.1 This report accords with the CIPFA Code of Practice for Treasury Management and best practice. The Code recommends that members are informed of Treasury activities at least twice a year. The report:

- reviews the Council's treasury management activities for the first six months of the financial year 2017/2018;
- details those areas of activity that formed the basis of the Treasury Management Strategy Statement, Annual Minimum Revenue Provision Policy Statement & Annual Investment Strategy 2017/2018 received by Full Council on **27 February 2017 (Minute A16/17)**; and
- demonstrates the Council's compliance with the 2011 Prudential Code for Capital Finance ("The 2011 Code") in the first half of the year and sets out revised Prudential Indicators for 2017/2018.

3.1 BACKGROUND

3.1.1 The Council has adopted a Treasury Management Policy Statement, which sets out the basis on which treasury activities are to be conducted. This document is incorporated in the Council's Financial Regulations.

3.1.2 The Treasury Management Policy Statement sets out the arrangement for reporting to Members prior to the commencement of each financial year (a statutory requirement) on the treasury strategy for the year ahead, to receive a mid-year review of treasury activities and to receive a review of the previous year's activities.

3.1.3 The Council's treasury management objectives are to manage the cash flows, borrowing and investment requirements of the authority with minimum risk and to achieve this by minimising the Council's exposure to adverse movements in interest rates whilst maximising investment yield to enhance the Council's finances.

3.1.4 The Council's treasury management activities are regulated by statute, the 2011 Code and official guidance.

3.1.5 This report presents a mid-year review of 2017/2018's activities based on the following:

- The Economy and Interest Rates
- Lending;
- Borrowing;
- Compliance with Prudential Indicators;
- Repayment of Debt and Debt Rescheduling;
- Minimum Revenue Provision; and
- Performance Targets.

3.1.6 A glossary of the terms and abbreviations used in this report is attached at **Appendix D.**

3.2 The Economy and Interest Rates

3.2.1 After the UK economy surprised on the upside with strong growth in 2016, growth in 2017 has been disappointingly weak; quarter 1 came in at only +0.3% (+1.7% y/y) and quarter 2 was +0.3% (+1.5% y/y) which meant that growth in the first half of 2017 was the slowest for the first half of any year since 2012. .The main reason for this has been the sharp increase in inflation, caused by the devaluation of sterling after the referendum, feeding increases in the cost of imports into the economy. This has caused, in turn, a reduction in consumer disposable income and spending power and so the services sector of the economy, accounting for around 75% of GDP, has seen weak growth as consumers cut back on their expenditure. However, more recently there have been encouraging statistics from the manufacturing sector which is seeing strong growth, particularly as a result of increased demand for exports. It has helped that growth in the EU, our main trading partner, has improved significantly over the last year. However, this sector only accounts for around 11% of GDP so expansion in this sector will have a much more muted effect on the average total GDP growth figure for the UK economy as a whole.

3.2.2 The Monetary Policy Committee (MPC) meeting of 14 September 2017 surprised markets and forecasters by suddenly switching to a much more aggressive tone in terms of its words around warning that Bank Rate will need to rise. The Bank of England Inflation Reports during 2017 have clearly flagged up that they expected CPI inflation to peak at just under 3% in 2017, before falling back to near to its target rate of 2% in two years' time. Inflation actually came in at 2.9% in August, (this data was released on 12 September), and so the Bank revised its forecast for the peak to over 3% at the 14 September meeting MPC. This marginal revision can hardly justify why the MPC became so aggressive with its wording; rather, the focus was on an emerging view that with unemployment falling to only 4.3%, the lowest level since 1975, and improvements in productivity being so weak, that the amount of spare capacity in the economy was significantly diminishing towards a point at which they now needed to take action. In addition, the MPC took a more tolerant view of low wage inflation as this now looks like a common factor in nearly all western economies as a result of increasing globalisation. This effectively means that the UK labour faces competition from overseas labour e.g. in outsourcing work to third world countries, and this therefore depresses the negotiating power of UK labour. However, the Bank was also concerned that the withdrawal of the UK from the EU would effectively lead to a decrease in such globalisation pressures in the UK, and so would be inflationary over the next few years.

3.2.3 The MPC actually increased Bank Rate to 0.5% in November 2017. The MPC also gave forward guidance that they expected to increase Bank Rate only twice more in the next three years to reach 1.0% by 2020. This is, therefore, not quite the 'one and done' scenario but is, nevertheless, a very relaxed rate of increase prediction in Bank Rate in line with previous statements that Bank Rate would only go up very gradually and to a limited extent.

3.2.4 While there is so much uncertainty around the Brexit negotiations, consumer confidence, and business confidence to spend on investing, it is far too early to be confident about how the next two years will pan out.

3.2.5 Interest rate forecasts as provided by the Council's independent treasury advisers, Capita Asset Services, are detailed below.

Table 1: Economic Forecasts for End of Quarter (Q) – Capita Asset Services 14 November 2017

	Q4 17	Q1 18	Q2 18	Q3 18	Q4 18	Q1 19	Q2 19	Q3 19
Bank Rate	0.50%	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%
5yr PWLB rate	1.50%	1.60%	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%
10yr PWLB rate	2.10%	2.20%	2.30%	2.40%	2.40%	2.50%	2.60%	2.60%
25yr PWLB rate	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%
50yr PWLB rate	2.50%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%

3.2.6 These projections show that market commentators expect there to be one more 0.25% rate rise over the next two years. This means that the Authority should not expect a material upturn in the interest earned on cash balances in the current financial year. This market intelligence will contribute to treasury management decisions to enable effective risk management. It is informative to compare and contrast with the forecast presented in February that at that point in time the consensus was that the then current bank rate of 0.25% was expected to remain in place until after the Brexit negotiations had been completed. Public Works Loan Board (PWLB) rates for 25-year loans, at that point at 2.90% were expected to remain the same until Q4 2017. The 50-year PWLB rate, which was at 2.70%, was also expected to remain the same until Q4 2017. The message to take from this is that is clearly very difficult to derive consistent forecasts and that market volatility has a significant impact.

3.3 Lending

3.3.1 The Council's investment policy is governed by Communities and Local Government Office (CLG) guidance which has been implemented in the Annual Investment Strategy approved by Full Council **on 27 February 2017 (Minute A16/17)**. As set out in the strategy, the criteria for the investment of the Council's surplus funds are based on formal credit ratings issued by the FITCH International Rating Agency and supplemented by additional market data such as rating outlooks, the pricing of credit default swaps and bank share prices. The prime aim is to obtain capital security and then to secure the best rate of return. In addition to the FITCH rated institutions, all UK local authorities, and some public bodies comprise the Council's Approved Lending List.

3.3.2 Since the strategy was drafted, the implied sovereign support rating for counterparties has been removed with both the Standard & Poor's and Moody's rating agencies withdrawing all sovereign support ratings. The FITCH rating agency, which the Council and Capita adheres to, still assesses the implied sovereign support rating although the importance of this rating is now diluted. This has resulted in the Council adopting revised minimum credit rating criteria for institutions to be included within the authorised lending list. This revised criteria was approved by **General Purposes and Audit Committee on 27 February 2017 (Minute A16/17)** and is as follows:

Table 2: Lending List Criteria

List	Credit Ratings Criteria
A	**FITCH rating in each of the following categories:-** F1+ on Short Term AA or above Long Term aa- or above Viability Rating 5 for Support Rating AA+ or above Sovereign Rating
B	**FITCH Rating in each of the following categories:-** F1+ on Short Term AA- or above on Long Term a+ or above Viability Rating 5 for Support Rating AA+ or above Sovereign Rating

Approved Organisations
All Non-UK Banks that meet the FITCH ratings as set out above
All UK Building Societies that meet the FITCH ratings as set out above
UK Banks that meet the FITCH ratings as set out above

Approved Organisations not meeting the above credit ratings
Part Nationalised UK Banks
All UK Local Authorities
AAA rated Money Market Funds
Debt Management Office (DMO)

3.3.3 The Council's authorised list of counterparties as at 30 September 2017 is detailed in **Appendix A.** The list and the counterparty limits applicable have been drawn up to provide maximum security for the Council's funds. Note that although there are three rating agencies, of these Moody's and Standard & Poor's focus on the US markets while FITCH concentrates on Europe and is thus the preferred choice for use here. The CIPFA guidelines require that local authorities factor in the lowest of the three potential ratings, providing an overall check. For Money Market Funds, a minimum of AAA ratings by at least 2 rating agencies one of whom must be FITCH is required for inclusion onto the Council's authorised lending list.

3.3.4 The principle of ensuring capital security and then of securing the best rate of return underpins all treasury investment decisions. When setting the present strategy allowance was made to enable investment in a range of other instruments that offered the potential for slightly better returns at commensurate levels of risks. To this end custodian arrangements were put in place with the Bank of New York Mellon. Market conditions have not favoured investment in such non-term deposits but should conditions become more favourable these options will be explored. A list of the Specified and Non-Specified investments that Officers are permitted to undertake in-house, which was approved by Full Council on **27 February 2017 (Minute A16/17),** is detailed in **Appendix B.**

3.3.5 The financial year 2017/2018 continues the challenging investment environment of previous years, namely low investment returns and continuing heightened levels of counterparty risk.

3.3.6 Investment activity in the first half of 2017/2018 conformed to the approved strategy and the Council experienced no liquidity issues in the year to date with an average monthly balance of £115.4m being maintained in temporary investments. Part of this sum is made up of core balances such as provisions and reserves set aside and cash balances that can if necessary be invested for longer periods to take advantage of favourable interest rates and to limit exposure to the risk of future rate movements.

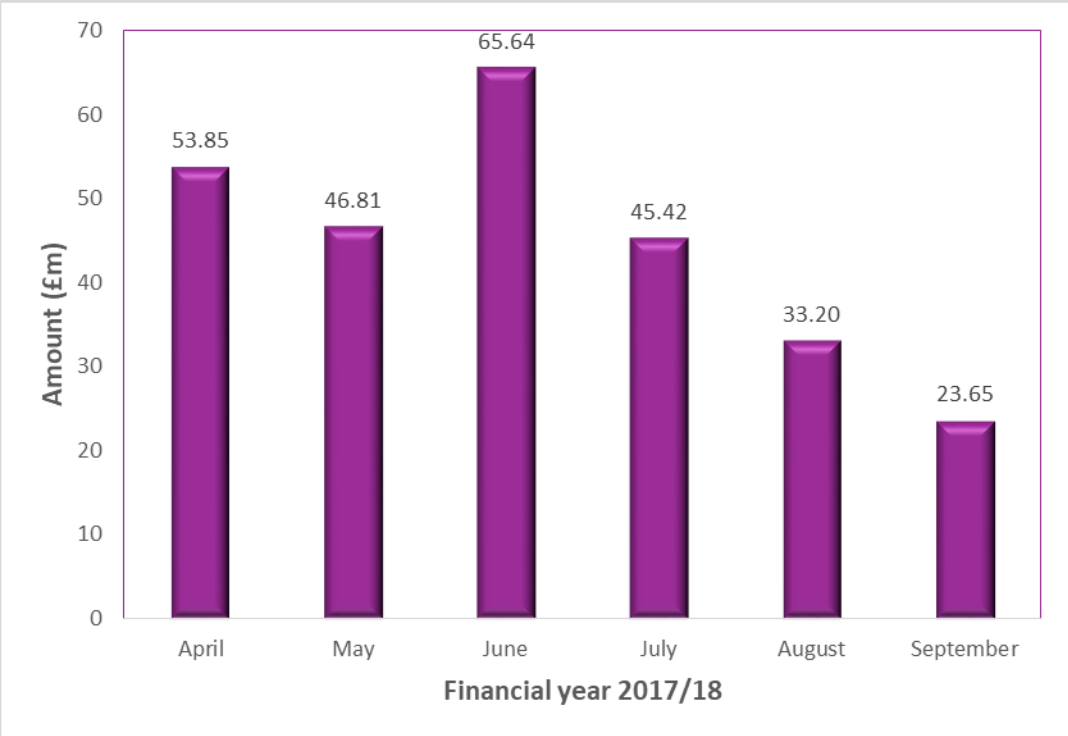
3.3.7 Available funds were invested for differing periods, to match anticipated movements in the Council's daily cash flows commensurate with achieving best value and based on forecasts of interest rate trends. The primary aim is to ensure the capital security of the Council's investments and then to secure the best rate of return.

3.3.8 Investment of the Council's cash balances is governed by the guidance on Local Government Investments which has been issued by the Department for Communities and Local Government (DCLG). This guidance requires certain investment policy parameters to be set within the annual Treasury Management

Strategy Statement, Annual Minimum Revenue Provision Policy Statement and Annual Investment Strategy approved by Council. Investment activity during the year conformed to this approved strategy and sufficient liquidity was maintained for the Council's cash flow requirements.

3.3.9 In aggregate for the first half of 2017/2018, deposits totalling £268.5m were invested and the Council maintained an average monthly balance of £115.4m yielding an investment rate of return of 0.44% compared to the LIBID 7 day rate of 0.23% and LIBID 6 month rate of 0.49% for the year. Investments outstanding at 30 September 2017 were £80.2m. These were invested as follows: £15m with UK banks, Non-UK banks £35.0m, other local authorities £30.0m and £0.2m with AAA rated Money Market Funds.

Chart 1: Investments made in 2017/2018



3.4 Borrowing

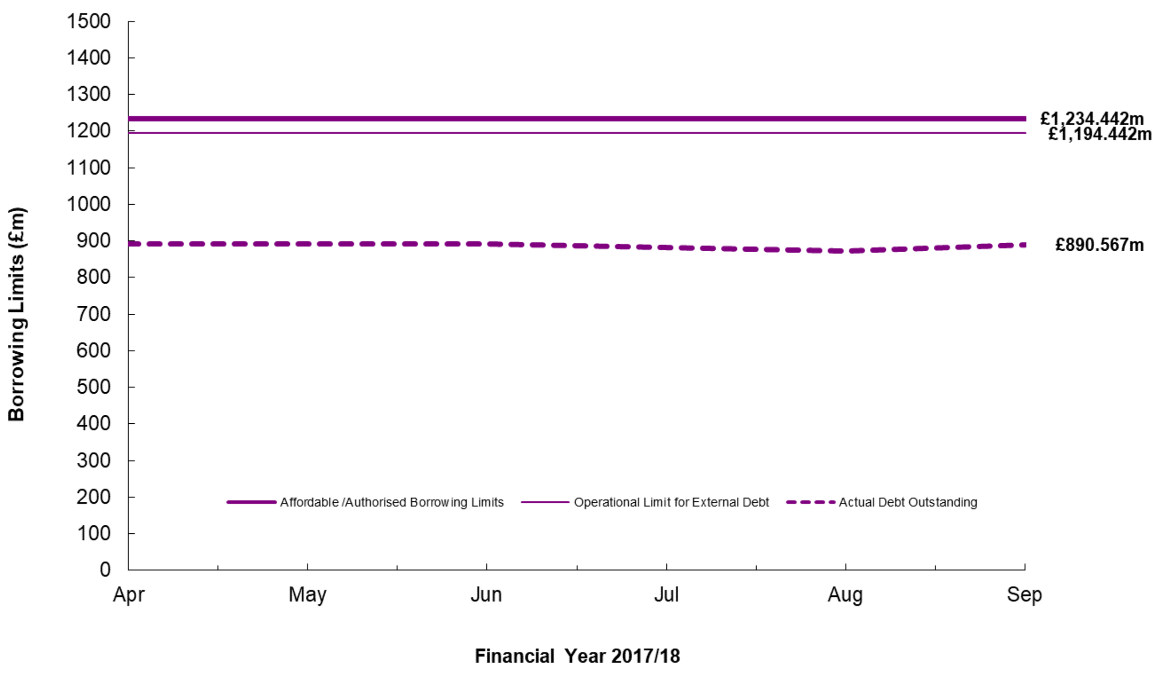
3.4.1 The Council set borrowing limits that were approved by **Full Council on 27 February 2017 (Minute A16/17 refers)** for the year 2017/2018 as part of the legislative constraints specified in Section 3 of the Local Government Act 2003 which require the Council to determine and keep under review how much it can afford to borrow.

The limits were:

Operational Limit for External Debt	£1,194.442m
Affordable Borrowing Limit	£1,234.442m
Authorised Borrowing Limit	£1,234.442m

The chart below shows the actual debt in the first half of 2017/2018 in relation to the borrowing limits applicable at the time.

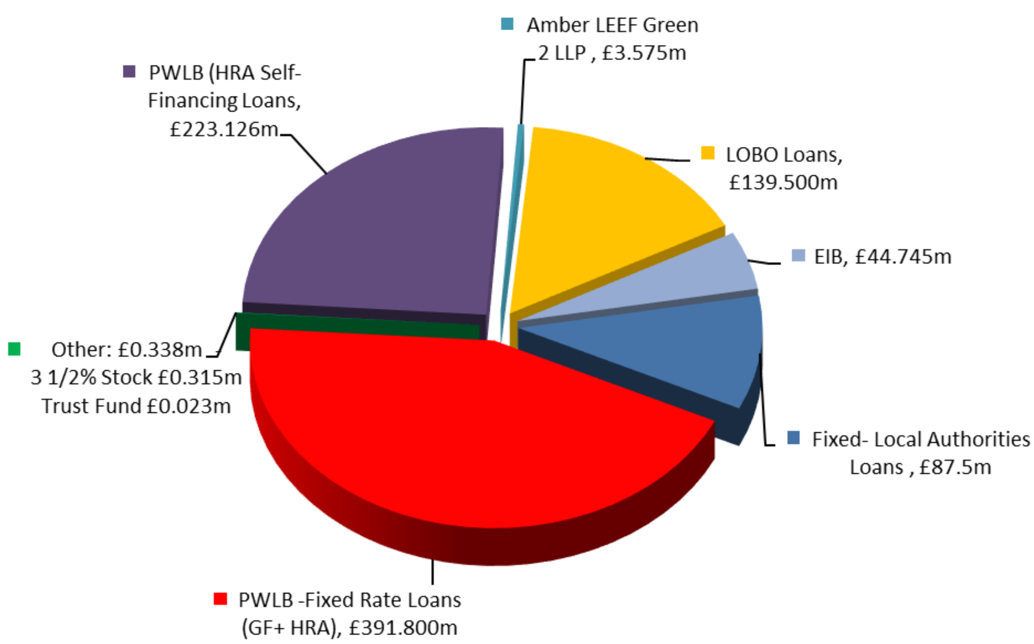
Chart 2: Actual Debt in 2017/2018 in comparison to the Operational, Affordable and Authorised Borrowing Limits for the year



3.4.2 The Authorised Borrowing Limit which sets the maximum amount that the Council can borrow for capital and revenue purposes was not exceeded. The Council's overall borrowing as at 30 September 2017 stood at £890.567m. There was therefore considerable headroom to spare between this level of debt and the Authorised Borrowing Limit.

3.4.3 The Council's long term debt as at 30 September 2017 is detailed graphically as follows:

Chart 3: Long Term and Short Term Debt as at 30 September 2017



3.4.4 The estimated borrowing requirement for the financial year 2017/2018 has been revised downwards from £349.234m to £134m. This is due to revised scheduling of works and slippage. The treasury strategy has been to use existing cash balances, to limit the need for further borrowing, and thus to reduce the cost of debt to the Council. During the first half of the year the Council has used approximately £22m of its cash reserves to finance Capital spending and decreased its borrowing by £2.5m.

3.4.5 When taking up the remainder of this year's borrowing requirement the Council's Treasury Section will examine all the options available and will compare these against both the certainty rates offered by the PWLB and European Investment Bank (EIB) rates to ensure that the most advantageous rates possible are secured on long-term funding. Consideration will also be given to the use of internal balances to fund at least a part of the requirement if this proves economically more beneficial. Borrowing undertaken will be taken to fit into the Council's existing debt maturity profile to ensure an even distribution of maturities in future years. **Appendix C** displays the movements in the PWLB interest rates for the 5-year, 10-year, 25-year and 50-year loan periods during the first half of 2017/2018.

3.4.6 The Council's effective interest payable on long term debt currently stands at 3.8%.

3.5 Compliance with Prudential Indicators

3.5.1 The Prudential Code for Capital Finance in Local Authorities was updated in 2011. It serves as a professional code of practice to support local authorities in complying with Part 1 of the Local Government Act 2003. The Code required the continual monitoring of the Prudential Indicators set by the Council.

3.5.2 The purpose of the Prudential regime is to contain the activity of the treasury function within certain limits, thereby reducing the risk or likelihood of an adverse movement in interest rates or borrowing decisions impacting negatively on the Council's overall financial position.

3.5.3 We are compliant with the Prudential Indicators set by this Authority for 2017/2018**.**

3.6 Repayment of Debt and Debt Rescheduling

3.6.1 With PWLB rates low in the first half of 2017/2018 and with high premiums being attached to the premature repayment of existing PWLB debt, opportunities for debt restructuring were minimal and therefore none was undertaken.

3.6.2 Debt repayment / restructuring will only be done following external advice and only if it was proved beneficial for the Council. The Council's debt profile is structured so that loans mature over a spread of future dates. This takes advantage of the best rates offered at the time and ensures that refinancing risks are controlled. There is the risk however that when the Authority needs to take out a replacement loan, the market rates could have moved against the Council's position.

3.7 Minimum Revenue Provision

3.7.1 As part of the mid-year review of the 2015/2016 Minimum Revenue Provision Statement, the Council's General Purposes and Audit Committee approved a revised Annual Minimum Revenue Provision Statement on 9 December 2015 (Minute A62/15). The Council's MRP Policy Statement for 2017/2018 also adopts these revisions. Note that the Government is currently consulting on changes to their guidance relating to this statement.

3.8 Performance Targets

3.8.1 The gross investment income earned by the Council for the financial year 2017/2018 is forecast to be £0.75m.

3.8.2 The Council's actual investment return for the first half of 2017/2018 was 0.44% compared to the benchmark average 7-day LIBID rate of 0.23% and 6-month LIBID rate of 0.49%. Liquidity was maintained by investing in AAA rated Money Market funds at rates around 0.21% with some investments pitched over the 3, 6 and 12 month period at rates over 0.40% to produce returns in excess to the benchmark rate.

4 CONSULTATION

4.1 Full consultation in respect of the contents of this report has taken place with the Council's Treasury Management Advisers, Link Asset Services in the preparation of this report.

5 FINANCIAL CONSIDERATIONS

5.1 Revenue and Capital consequences of this report are dealt within this report.

There are no additional financial considerations other than those identified in this report.

5.2 **The effect of the decision**

Approval of this report will endorse the continued implementation of the Council's Treasury Management Strategy by the Executive Director of Resources (Section 151 Officer).

5.3 **Risks**

There are no further risks issues other than those already detailed in this report**.**

5.4 **Options**

These are fully dealt with in this report

5.5 **Savings/ future efficiencies**

This report sets out the treasury activities in the first half of 2017/2018 and demonstrates the Council's compliance with the Prudential Code and the limits set in both the Code and the Treasury Management Strategy Statement, Annual Minimum Revenue Provision Policy Statement and the Annual Investment Strategy 2017/2018 report presented to Members on **27 February 2017 (Minute A16/17)**.

Approved by: Lisa Taylor, Assistant Director of Finance and Deputy Section 151 Officer.

6. COMMENTS OF THE COUNCIL SOLICITOR AND MONITORING OFFICER

6.1 The Solicitor to the Council comments the Local Government Act 1972, Section 151 states that each local authority has a statutory duty to make arrangements for the proper administration of its financial affairs. The Council's Chief Financial Officer appointed under Section 151 is responsible for reporting to the committee on the activities of the treasury management operation.

6.2 A variety of professional codes, statues and guidance regulate specifically to the Council's treasury management activities.

6.3 The Local Government Act 2003 ('the Act') provides the powers to borrow and invest. It also imposes controls and limits on these activities. The Act permits the Secretary of State to set limits on either the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken.

6.4 The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 ('the SI') as amended develops the controls and powers within the Act. The SI requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code. The Prudential Code requires indicators to be set – some of which are limits – for a minimum of three forthcoming years. The SI also requires the Council to operate the overall treasury management function with regard to the CIFPA Treasury Management Code of Practice in Public Services. Under the terms of the Act the Government has issued "Investment Guidance" to structure and regulate the Council's investment activities. The emphasis of the guidance is on the security and liquidity of investments.

6.5 The Council has adopted the CIPFA Treasury Management Code of Practice in Public Services and a Treasury Management Policy Statement which is referred to in the Council's Constitution Financial Regulations Part 4H.

6.6 All treasury activity must comply with relevant statute, guidance and accounting standards.

Approved by: Sandra Herbert Head of Litigation and Corporate Law on behalf of Jacqueline Harris-Baker the Director of Law and Monitoring Officer.

7. HUMAN RESOURCES IMPACT

7.1 There are no immediate HR considerations that arise from the recommendation of this report for LBC staff.

Approved by: on behalf of Heather Daley, Director of Human Resources.

8. CUSTOMER IMPACT

8.1 There are no Customer impacts arising from this report.

9. EQUALITIES IMPACT ASSESSMENT (EIA)

9.1 Consistent with the requirements of equal opportunities legislation including the Public Sector Equality Duty, the Council carries out an equality impact assessment on new policies, or existing policies which are the subject of major change.

9.2 The Council's Capital and Revenue Budget 2016/2017 is not subject to an equality impact assessment. However, in those areas where the setting of the capital and revenue budget result in new policies or policy change, then it is the responsibility of the relevant service department to carry out an equality impact assessment which evaluates how the new or changed policy will impact on disadvantaged sections of the community, including disabled people. The impact assessment includes consultation with disabled people and user-led disabled people organisations.

10. ENVIRONMENT AND DESIGN IMPACT

10.1 There are no Environment and Design impacts arising from this report.

11. CRIME AND DISORDER REDUCTION IMPACT

11.1 There are no Crime and Disorder reduction impacts arising from this report.

12. HUMAN RIGHTS IMPACT

12.1 There are no Human Rights impacts arising from this report.

13. FREEDOM OF INFORMATION/DATA PROTECTION CONSIDERATIONS

13.1 There are no specific Data Protection or Freedom of Information considerations arising from this report.

CONTACT OFFICER:
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APPENDICES: Appendix A Authorised Lending List
Appendix B Local Government Investments
Appendix C PWL Movements
Appendix D Glossary of Terms

BACKGROUND DOCUMENTS:

CIPFA's Prudential Code for Capital Finance in Local Authorities Fully Revised Second Edition 2009 and updated 2011 edition.
CIPFA's Code of Practice for Treasury Management in the Public Services and Cross Sectoral Guidance Notes – Fully Revised Second Edition 2009 and updated 2011 edition.
CLG's Guidance on Local Government Investments March 2004.