

Title of meeting:	Governance and Audit and Standards Committee Cabinet City Council
Date of meeting:	Governance and Audit and Standards Committee 15 September 2017 Cabinet 28 September 2017 City Council 17 October 2017
Subject:	Treasury Management Mid-Year Review 2017/18
Report by:	Director of Finance and Information Services (Section 151 Officer)
Wards affected:	All
Key decision:	No
Full Council decision:	Yes

1. Executive Summary

This report seeks to increase the Council's authorised limit for external debt, ie. the amount of debt that it can hold by £10.6m from £607.6m to £618.2m and to increase the operational boundary by a corresponding amount.

This report also seeks to broaden the range of non-specified investments that the Council can invest in to include the proposed Energy Supply Company and any other subsidiary companies that that the Council may establish in addition to MMD (Shipping Services) Ltd.

This report outlines the Council's performance against the treasury management indicators approved by the Council on 21 March 2017.

2. Purpose of report

The purpose of the report is to inform members and the wider community of the Council's Treasury Management position at 31 July 2017 and to amend the Council's Treasury Management Strategy to reflect the Council's current circumstances.

In March 2009 the Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management Panel issued a bulletin on Treasury Management in Local Authorities. The bulletin states that "in order to enshrine best practice it is suggested that authorities report formally on Treasury Management activities at least twice yearly". The report in Appendix A covers the first four months of 2017/18.

3. Recommendations

- a That the authorised limit for external debt be increased by £10,600,000 from £607,555,000 to £618,155,000
- b That the operational boundary for external debt be increased by £10,600,000 from £589,255,000 to £599,855,000
- c That non-specified investments of up to £20m are permitted in the Council's subsidiary companies including but not restricted to MMD (Shipping Services) Ltd
- d That the actual Treasury Management indicators for July 2017 in Appendix A be noted

4. Background

The Council's treasury management operations cover the following:

- Cash flow forecasting (both daily balances and longer term forecasting)
- Investing surplus funds in approved investments
- Borrowing to finance short term cash deficits and capital payments
- Management of debt (including rescheduling and ensuring an even maturity profile)
- Interest rate exposure management

The key risks associated with the Council's treasury management operations are:

- Credit risk - ie. that the Council is not repaid, with due interest in full, on the day repayment is due
- Liquidity risk - ie. that cash will not be available when it is needed, or that the ineffective management of liquidity creates additional, unbudgeted costs
- Interest rate risk - that the Council fails to get good value for its cash dealings (both when borrowing and investing) and the risk that interest costs incurred are in excess of those for which the Council has budgeted
- Maturity (or refinancing risk) - this relates to the Council's borrowing or capital financing activities, and is the risk that the Council is unable to repay or replace its maturing funding arrangements on appropriate terms
- Procedures (or systems) risk - ie. that a treasury process, human or otherwise, will fail and planned actions are not carried out through fraud, error or corruption

The total borrowings of the Council are £576m. The Council has investments lodged with 52 institutions that amount to £465.5m. The cost of the Council's borrowings and the income derived from the Council's investments are included within the Council's treasury management budget of £22m per annum. The Council's treasury management activities account for a significant proportion of the Council's overall budget. As a consequence the Council's Treasury Management Policy aims to manage risk whilst optimizing costs and returns. The Council monitors and measures its treasury management position against the indicators described in this report. Treasury management monitoring reports are brought to the Governance and Audit and Standards Committee for scrutiny.

5. Reasons for Recommendations

The Council's total external debt, including finance leases and service concessions including private finance initiative (PFI) schemes must not exceed the Council's authorised limit for external debt. The Council's external debt including finance leases and service concessions amounted to £576m as at 31 July 2017, £32m below the authorized limit for external debt. The Council has entered into a £10.6m finance lease for the Isle of Wight ferry terminal to enable it to fulfil its obligations to Wightlink following the disposal of the head lease for this site. It is recommended that the authorised limit for external debt be increased by £10,600,000 from £607,555,000 to £618,155,000 in order to maintain the Council's capacity to borrow to either fund either capital expenditure or temporary cash deficits.

It is recommended that the operational boundary be increased by a similar amount to the authorised limit. The operational boundary is based on probable external debt. It is not a limit, but acts as a warning mechanism to prevent the authorised limit being breached.

The Treasury Management Policy approved by the City Council on 21 March provides for up to £2m to be invested in the Council's subsidiary company MMD (Shipping Services) Ltd. On 29 July the Cabinet approved the outline business case to establish a municipal energy supply company. This is estimated to require circa £8m of cash flow support. In addition the 2017/18 budget had a stronger focus on entrepreneurial activities to generate income which could lead to the establishment of further subsidiary companies. It is recommended that the Treasury Management Policy be amended to permit up to £20m to be invested in subsidiary companies including but not restricted to MMD (Shipping Services) Ltd.

To highlight any variance from the approved Treasury Management Policy and to note any subsequent actions.

To provide assurance that the Council's treasury management activities are effectively managed.

6. Equality impact assessment (EIA)

The contents of this report do not have any relevant equalities impact and therefore an equalities impact assessment is not required.

7. Legal Implications

The Section 151 Officer is required by the Local Government Act 1972 and by the Accounts and Audit Regulations 2015 to ensure that the Council's budgeting, financial management, and accounting practices meet the relevant statutory and professional requirements. Members must have regard to and be aware of the wider duties placed on the Council by various statutes governing the conduct of its financial affairs.

8. Director of Finance's comments

All financial considerations are contained within the body of the report and the attached appendices

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Signed by Director of Financial Services & IS (Section 151 Officer)

Appendices:

Appendix A: Treasury Management Mid-Year Review 2017/18

Appendix B: Debt Maturity Profile

Appendix C: LIBOR Rates

Background list of documents: Section 100D of the Local Government Act 1972

The following documents disclose facts or matters, which have been relied upon to a material extent by the author in preparing this report:

<u>Title of document</u>	Location
1 Information pertaining to treasury management strategy and performance	Financial Services
2	

TREASURY MANAGEMENT MID YEAR REVIEW OF 2017/18**1. SUMMARY OF TREASURY MANAGEMENT INDICATORS AS AT 31 JULY**

The Council's debt at 31 July was as follows:

	Original Prudential Indicator	Recommended Prudential Indicator	Position at 31/7/17
Authorised Limit	£608m	£618m	£576m
Operational Boundary	£589m	£600m	£576m

The maturity structure of the Council's borrowing was:

	Under 1 Year	1 to 2 Years	3 to 5 Years	6 to 10 Years	11 to 20 Years	21 to 30 Years	31 to 40 Years	41 to 50 Years
Lower Limit	0%	0%	0%	0%	0%	0%	0%	0%
Upper Limit	10%	10%	10%	20%	30%	30%	30%	40%
Actual	1%	4%	4%	6%	22%	11%	21%	31%

Sums invested for periods longer than 364 days at 31 July 2017 were:

Maturing after	Limit £m	Actual £m
31/3/18	168	128
31/3/19	148	15
31/3/20	144	15

The Council's interest rate exposures at 31 July 2017 were:

	Limit £m	Actual £m
Fixed Interest	389	305
Variable Interest (net Investments)	(389)	(288)

2. GOVERNANCE

The Treasury Management Policy Statement, Annual Minimum Revenue Provision for Debt Repayment Statement and Annual Investment Strategy approved by the City Council on 21 March 2017 provide the framework within which Treasury Management activities are undertaken.

3. NET DEBT

On 31 July 2017 the Council had gross debt including finance leases and private finance initiative (PFI) schemes of £576m and gross investments of £465m giving rise to a net debt of £111m. The current high level of investments has arisen from the Council's earmarked reserves and borrowing in advance of need to take advantage of low borrowing rates thus securing cheap funding for the Council's capital programme. The current high level of investments does increase the Council's exposure to credit risk, ie. the risk that an approved borrower defaults on the Council's investment. In the interim period when investments are high in advance of capital expenditure being incurred, there is also a short term risk that the rates (and therefore the cost) at which money has been borrowed will be greater than the rates at which those loans can be invested.

4. BORROWING ACTIVITY

The Council employs Capita Asset Services to provide interest rate forecasts. The forecast overall longer run trend is for gilts and Public Works Loans Board (PWLB) certainty rates to rise, albeit gently, with 25 year rates expected to rise from their current 2.6% to 3.3% by December 2019.

The Council did not undertake any new borrowing in the first four months of 2017/18.

The Council's gross debt at 31 July 2017 of £576m is within the Council's authorised limit (the maximum amount of borrowing permitted by the Council) of £608m and the Council's operational boundary (the maximum amount of borrowing that is expected) of £589m. The Council aims to have a reasonably even maturity profile so that the Council does not have to replace a large amount of borrowing in any particular year when interest rates might be high. The maturity profile of the Council's borrowing (Appendix B) is within the limits contained in the Council's Treasury Management Policy (see paragraph 1).

5. INVESTMENT ACTIVITY

In accordance with the Government's statutory guidance, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite.

Investment rates available in the market for investments that are longer than 3 months have followed a downward trend in the first four months of 2017/18. Market rates available for shorter term investments have remained stable in line with the 0.25% Bank of England base rate. Short term market interest rates for the first four months of 2017/18 are shown in Appendix C.

The Council's investment portfolio has increased by 7% in 2017/18 from £436.7m on 1 April to £465.5m as at 31 July largely due to a number of income streams including Council Tax receipts tending to be front loaded.

The overall investment portfolio yield for the first four months of the year was 0.94%.

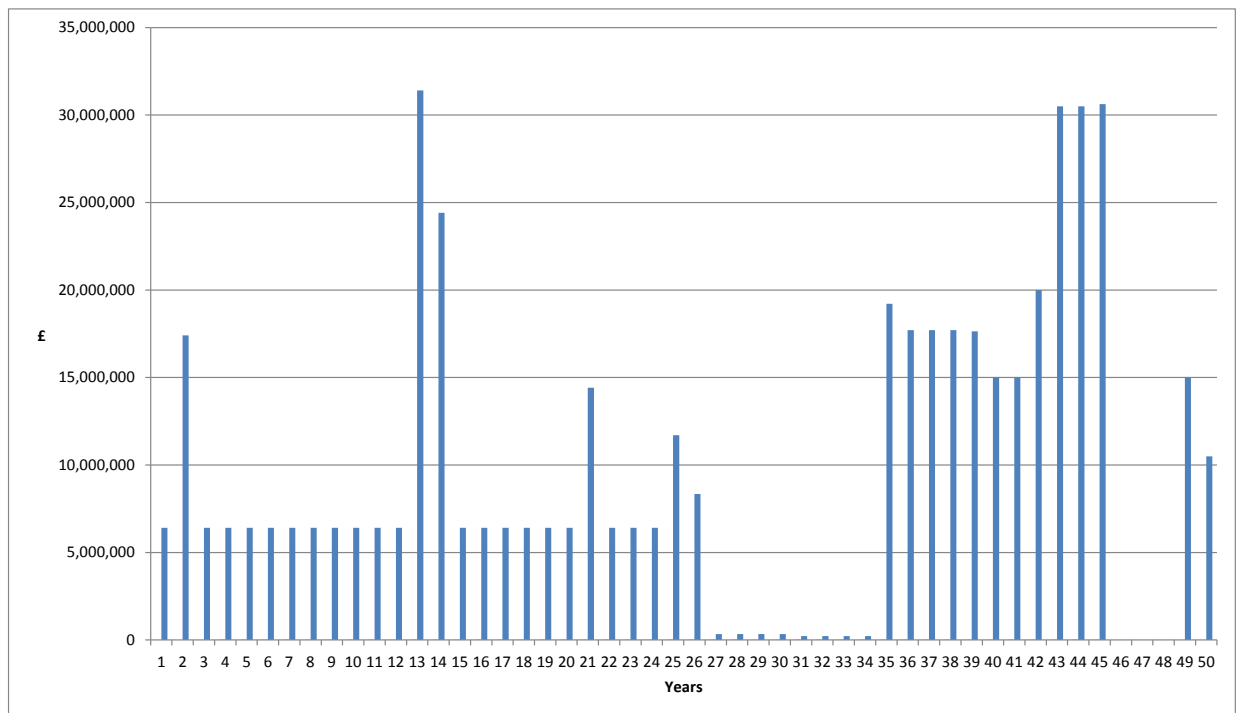
The Council's budgeted investment return for 2017/18 is £2,730k, and performance for the year to date is £582k above budget. This is due to having better than anticipated investment returns.

The current investment portfolio yield is unlikely to be maintained as maturing investments are having to be replaced with lower yielding investments reflecting the current market and the current Bank of England base rate of 0.25%.

6. INTEREST RATE EXPOSURES

Fixed interest rates avoid the risk of budget variances caused by interest rate movements, but prevent the Council from benefiting from falling interest rates on its borrowing or rising interest rates on its investments. The Council's net fixed interest rate borrowing at 31 July 2017 was £305m which was within the limit set in the 2017/18 Treasury Management Policy of £389m. Variable interest rates expose the Council to the benefits and dis-benefits of interest rate movements and can give rise to budget variances. The Council's net variable interest rate investments at 31 March 2017 were £288m which was within the limit set in the 2017/18 Treasury Management Policy of £389m.

DEBT MATURITY PROFILE



LIBOR RATES

