Title of meeting:	Governance and Audit and Standards Committee Cabinet City Council
Date of meeting:	Governance and Audit and Standards Committee 2 November 2018 Cabinet 6 November 2018 City Council 13 November 2018
Subject:	Treasury Management Mid-Year Review 2018/19
Report by:	Director of Finance and Information Technology (Section 151 Officer)
Wards affected:	All
Key decision:	No
Full Council decision:	Yes

1. Executive Summary

This report recommends some minor updates to the Council's policy on providing for the repayment of debt, known as its minimum revenue provision (MRP) policy, and outlines the Council's performance against the treasury management indicators approved by the Council on 20 March 2018.

2. Purpose of report

The purpose of the report is to recommend some minor updates to the Council's MRP policy following discussions with the Council's external auditors, and to inform members and the wider community of the Council's Treasury Management position at 30 September 2018.

In March 2009 the Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management Panel issued a bulletin relating to 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 and preferably quarterly". The report in Appendix A covers the first six months of 2018/19.

3. Recommendations

It is recommended that:

3.1 If the carrying (market) value of an investment property falls below the original value of unsupported borrowing incurred to acquire the investment property excluding fees and other associated costs, minimum revenue provision (MRP) will be charged over the residual life of the property on the shortfall between the current property value and the value of borrowing.

3.2 minimum revenue provision (MRP) be provided on equity shares over 25 years on an annuity basis.

3.3 It be noted that there have been no breaches of the Treasury Management Policy 2018/19 in the period up to 30 September 2018.

3.4 the actual Treasury Management indicators for September 2018 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:

1. Credit risk - ie. that the Council is not repaid, with due interest in full, on the day repayment is due
2. Liquidity risk - ie. that cash will not be available when it is needed, or that the ineffective management of liquidity creates additional, unbudgeted costs
3. 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
4. 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
5. 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 £623m and statutory guidance requires the Council to provide for its repayment. The Council has made a number of amendments to its MRP policy in recent years and has informed the external audit manager at the time of its intentions. The Council's external auditors have now engaged their specialist staff to undertake a review of the Council's MRP policy. As a result of previous MRP policies the Council has provided for the repayment of debt much earlier than when the actual repayments are required to be made and has as a result been reducing its MRP in order to recover this over provision over a prudent time scale. The auditors are reviewing the amount of the excess MRP made in previous years rather than the amount of MRP being made in the current year. Therefore the effect of the auditors' MRP review will be to shorten the period over which the Council makes a reduced MRP rather than to increase MRP immediately.

The Council has investments lodged with 56 institutions that amount to £414m.

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 £23m 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.

There have been no breaches of the Treasury Management Policy up to the period ending 30 September 2018.

5. Reasons for Recommendations

Recommendation 3.1

The Council's existing policy is to provide for the repayment of debt used to finance investment properties by utilising the capital receipt generated from their sale. The market value of the Council's investment properties is expected to increase over time. However, the commercial property market is cyclical and there is a risk that the market value of an investment property could fall preventing the debt from being entirely provided for through the capital receipt realised from selling the property. In order to be prudent it is therefore recommended that if the carrying (market) value of an investment property falls below the unsupported borrowing amount, minimum revenue provision (MRP) will be charged over the residual life of the property on the shortfall of the balance. There has been no diminution in the value of the Council's investment properties that have been financed from unsupported borrowing.

Recommendation 3.2

The Council's existing policy is that no MRP is made on self - financed borrowing to fund equity shares purchased in pursuit of policy objectives unless the shares are sold in which case the capital receipt is set aside to repay the debt. The Council's equity shares are expected to hold their value unlike physical assets that depreciate.

None the less, the Council has no plans to sell its equity shares and therefore no provision is being made for the repayment of the borrowing that financed the equity investments. In order to ensure that provision is made to repay debt associated with the acquisition of equity shares, it is therefore recommended that minimum revenue provision (MRP) be provided on equity shares over 25 years on an annuity basis.

Recommendation 3.3

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

Recommendation 3.4

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 & Information Technology (Section 151 Officer)

Appendices:

Appendix A: Treasury Management Mid-Year Review 2018/19
Appendix B: LIBID Rates
Appendix C: Composition of Cash Investments with Investment Returns at 30 September 2018

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:

	Title of document	**Location**
1	Information pertaining to treasury management strategy and performance	Financial Services

APPENDIX A

TREASURY MANAGEMENT MID YEAR REVIEW OF 2018/19

A1. SUMMARY OF TREASURY MANAGEMENT INDICATORS AS AT 30 SEPTEMBER

The Council's debt at 30 September was as follows:

	Limit	Position at 30/9/18
Authorised Limit	£660m	£623m
Operational Boundary	£645m	£623m

The maturity structure of the Council's fixed rate 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%	1%	4%	7%	24%	11%	25%	27%

The maturity structure of the Council's variable rate 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%	10%
Actual	2%	2%	7%	12%	24%	26%	27%	0%

Sums invested for periods longer than 365 days at 30 September 2018 were:

Maturing after	Limit £m	Actual £m
31/3/19	158	133
31/3/20	133	85
31/3/21	110	27

The Council's interest rate exposures at 30 September 2018 were:

	Limit £m	**Actual** £m
Fixed Interest - Borrowing and (Lending)	454	362
Variable Interest - Borrowing and (Lending)	(289)	(153)

A2. GOVERNANCE

The Treasury Management Policy Statement, Annual Minimum Revenue Provision for Debt Repayment Statement and Annual Investment Strategy approved by the City Council on 20 March 2018 provide the framework within which Treasury Management activities are undertaken.

In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued revised Prudential and Treasury Management Codes. As from 2019/20, all local authorities will be required to prepare a Capital Strategy which is intended to provide the following: -

- a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
- an overview of how the associated risk is managed
- the implications for future financial sustainability

A report setting out the Council's Capital Strategy will be taken to the Cabinet and the City Council, before 31st March 2019.

A3. COMBINED BORROWING AND INVESTMENT POSITION (NET DEBT)

On 30 September 2018 the Council had gross debt including finance leases and private finance initiative (PFI) schemes of £623m and gross investments of £414m giving rise to a net debt of £209m. 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. The difference between current borrowing and investment rates is 0.55%. Securing cheap funding for the capital programme will provide longer term savings through reduced borrowing costs.

A4. BORROWING ACTIVITY

The Council employs Link Asset Services to provide interest rate forecasts. The flow of generally positive economic statistics after the end of the quarter ended 30 June meant that it came as no surprise that the Monetary Policy Committee (MPC) came to a decision on 2 August to make the first increase in Bank Rate above 0.5% since the financial crash, to 0.75%. However, the MPC emphasised again, that future Bank Rate increases would be gradual. It is not anticipated that the MPC will increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. The MPC is more likely to wait until August 2019, than May 2019, before the next increase, to be followed by further increases of 0.25% in May and November 2020 to reach 1.5%. However, the cautious pace of even these limited increases is dependent on a reasonably orderly Brexit.

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 2.8% to 3.5% by December 2020.

The Council did not undertake any new borrowing in the first six months of 2018/19.

The Council's gross debt at 30 September 2018 of £623m is within the Council's authorised limit (the maximum amount of borrowing permitted by the Council) of £660m and the Council's operational boundary (the maximum amount of borrowing that is expected) of £645m. 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 is within the limits contained in the Council's Treasury Management Policy (see paragraph A1).

A5. INVESTMENT ACTIVITY

In accordance with the Government's statutory guidance, the Council's investment strategy is based on securing the return of capital above other considerations.

Investment rates available in the market for investments that are longer than 3 months have followed a downward trend in the first two months of 2018/19 but have since risen in anticipation of an increase in the Bank of England base rate. Short term market interest rates for the first six months of 2018/19 are shown in Appendix B.

The Council's investment portfolio has decreased by 1% in 2018/19 from £418.7m on 1 April to £414.2m as at 30 September.

The overall investment portfolio yield for the first six months of the year was 1.07%.

The Council's budgeted investment return for 2018/19 is £2,293k, and performance for the year to date is £1,174k above budget. This is due to having more cash than anticipated to invest following slippage in the capital programme and having better than anticipated investment returns.

A summary of the Council's investment portfolio is contained in Appendix C. The investment returns shown are as at 30 September 2018 and are not the cumulative returns over the first six months of 2018/19. Investment returns shown are influenced by the date upon which investments were made and the length of the investment in addition to the nature of the investment.

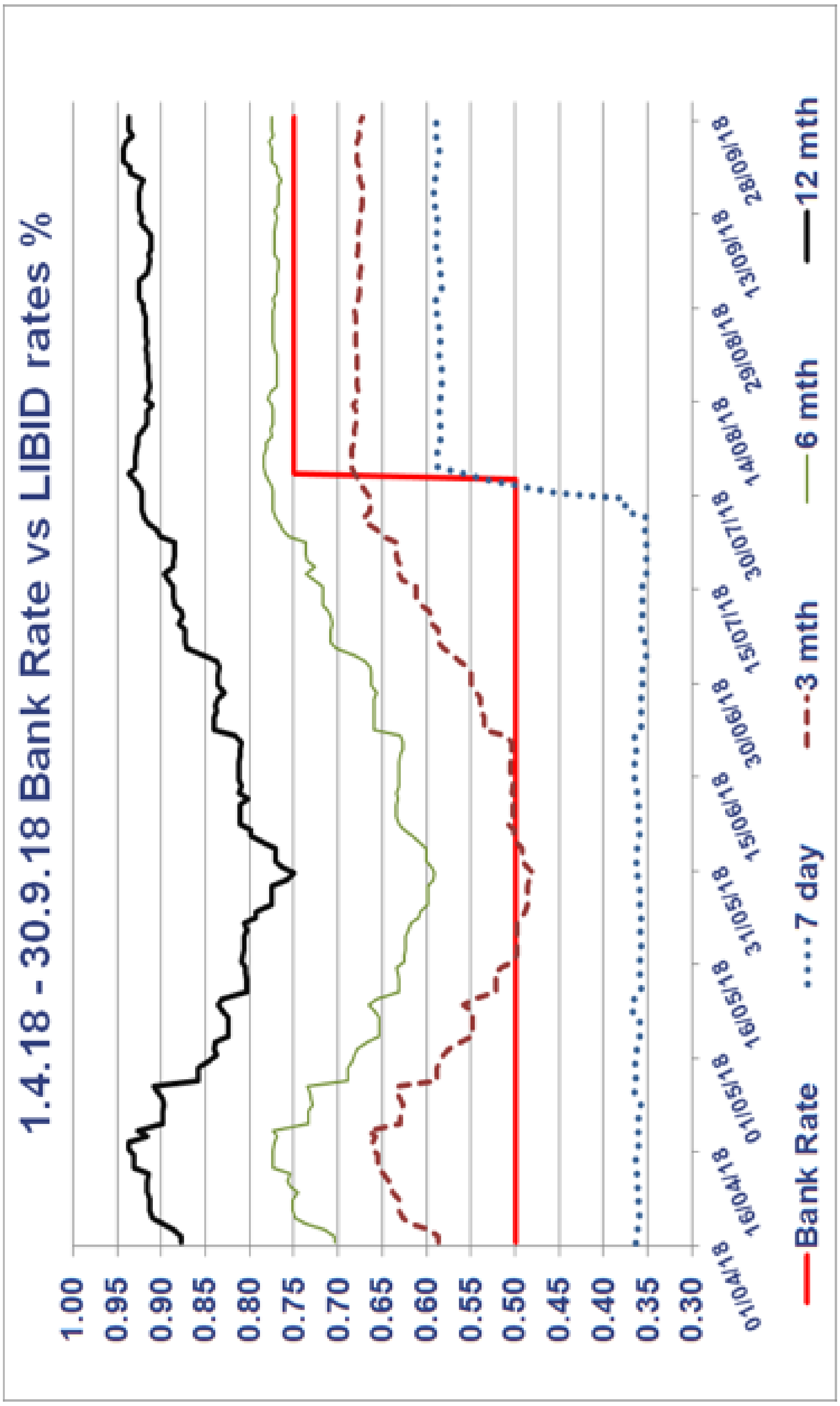
A6. INTEREST RATE EXPOSURES

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 30 September 2018 was £362m which was within the limit set in the 2018/19 Treasury Management Policy of £454m. 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 30 September 2018 were £153m which was within the limit set in the 2018/19 Treasury Management Policy of £289m.

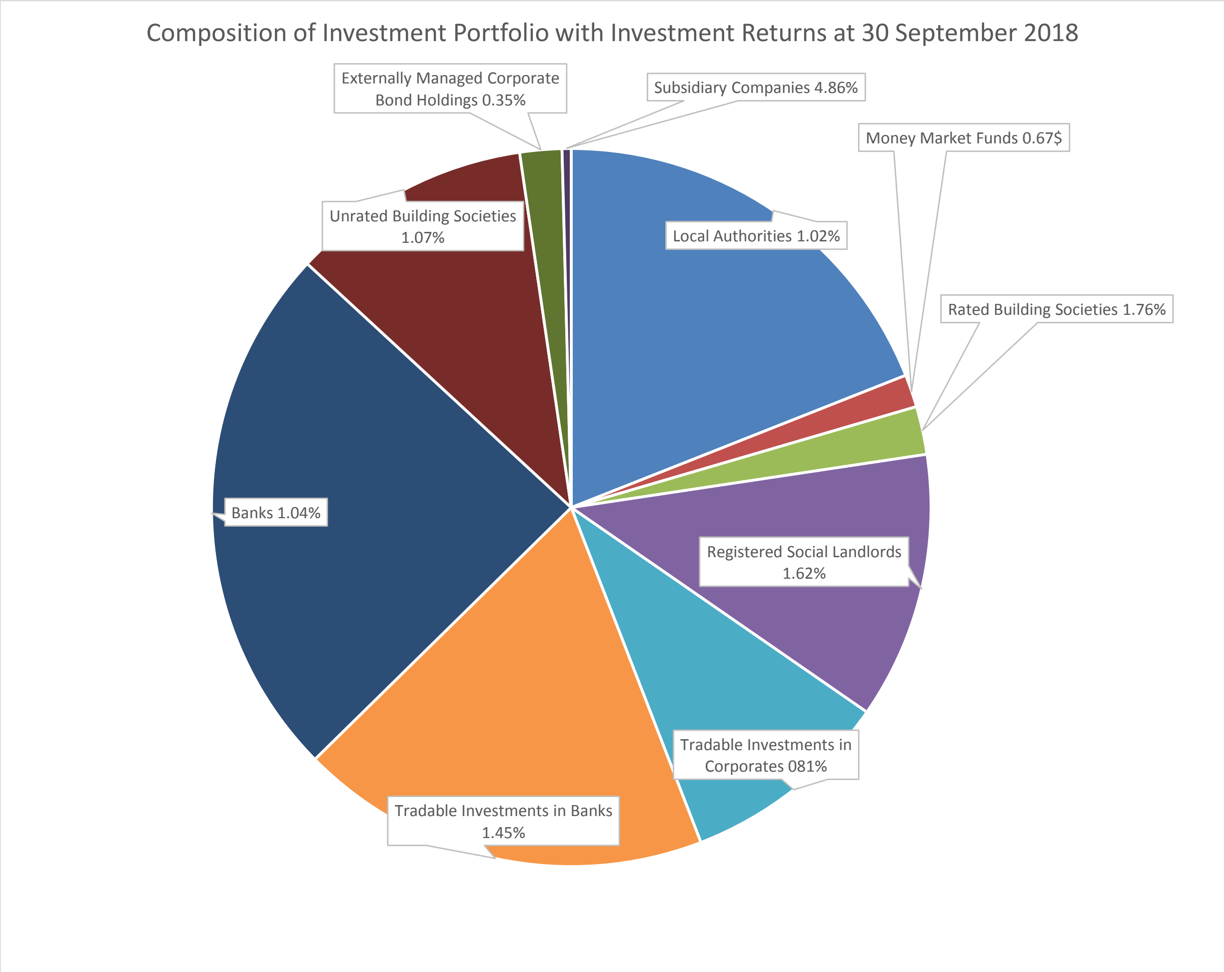
APPENDIX B

LIBID RATES

LIBID rates are London inter-bank bid rates and give an indication of the rates available in the London money market



APPENDIX C



Money market funds are instant access investments in AAA rated pooled funds.

Some investments in banks and corporates (commercial companies) are tradable. This means that the Council can sell the investments at any time to a third party. This contrasts with bank and building society term deposits which can only be repaid by the bank or building society.

The Council has some externally managed corporate bond holdings. These consist of tradable debt issued by commercial companies.