Cherwell District Council

Account, Audit and Risk Committee

12 September 2018

Treasury Management Report – July 2018

Report of the Executive Director – Finance and Governance

This report is public
Appendix 1 is exempt from publication by virtue of paragraph 3 of Schedule 12A of Local Government Act 1972

Purpose of report

To receive information on treasury management performance and compliance with treasury management policy for 2018/19 as required by the Treasury Management Code of Practice.

1.0 Recommendations

The meeting is recommended:

1.1 To note the contents of the July 2018 Treasury Management Report.

2.0 Introduction

2.1 As part of the investment strategy and governance arrangements, this committee considers the investment performance and compliance with the Council's Treasury Management Strategy.

2.2 The Code of Practice on Treasury Management approved by the Chartered Institute of Public Finance and Accountancy (CIPFA), and adopted in full by the Council in 2013, requires that a Treasury Management Strategy is produced prior to the beginning of the financial year to which it relates. Following consultation in 2017, CIPFA published new versions of the Prudential Code for Capital Finance in Local Authorities (Prudential Code) and the Treasury Management Code of Practice but has yet to publish the local authority specific Guidance Notes to the latter.

2.3 MHCLG published its revised Investment Guidance which came into effect from April 2018. The updated Prudential Code includes a new requirement for local authorities to provide a Capital Strategy, which is to be a summary document approved by full council covering capital expenditure and financing, treasury management and non-treasury investments. The Authority will be producing its Capital Strategy later in 2018/19 for approval by full Council.

2.4 The Treasury Management Strategy is the cornerstone of proper treasury management, and is central to the operation, management reporting and performance assessment. The annual strategy for Cherwell District Council for 2018/19 was approved at full Council on 26 February 2018. The Council appointed Arlingclose as its Treasury Management advisor in April 2017.

2.5 The highest standard of stewardship of public funds remains of the utmost importance to the Council. This document details the Council's management of investments and treasury management activities during the first four months of 2018/19.

3.0 Report Details

2018/19 Performance

3.1 As at the end of July 2018 the Council had borrowing of £91.5m and investments of £12.5m of funds managed in-house – a net borrowing position of £79m.
Appendix 1 details the schedule of borrowing and investments as at 31 July 2018.

Strategy

3.2 The Treasury Management Strategy for 2018/19 includes the Annual Investment Strategy which sets out the Council's investment priorities.

Security of capital has remained the Authority's main investment objective, followed by liquidity of capital, and then by yield. This has been maintained by following the Authority's counterparty policy as set out in its Treasury Management Strategy Statement for 2018/19.

3.3 Counterparty credit quality is assessed and monitored with reference to:

- Credit Ratings - the Authority's minimum long-term counterparty rating of A- (or equivalent) across rating agencies Fitch, S&P and Moody's
- Credit default swaps – a type of insurance to protect against default risk
- GDP of the country in which the institution operates
- The country's net debt as a percentage of GDP
- Sovereign support mechanisms or potential support from a well-resourced parent institution
- Share price

3.4 The Arlingclose ratings and advice encompass all of these and other factors and is our primary source of guidance in selecting investments. In addition to Arlingclose ratings and advice, the council keeps an internal counterparty 'Watch List' based on intelligence from a variety of other sources available to officers.

3.5 The Council's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Council's long-term plans change being a secondary objective.

3.6 In furtherance of these objectives new borrowing was kept to a minimum, whilst options for securing lower rates for longer term borrowing were reviewed. This strategy enabled the Council to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

3.7 The “cost of carry” analysis performed by the Council’s treasury management advisor Arlingclose did not indicate any value in borrowing in advance for future years’ planned expenditure and therefore none was taken.

3.8 All treasury management activities undertaken during the first 4 months of 2018/19 complied with the CIPFA Code of Practice and the Council’s approved Treasury Management Strategy, and all indicators were met during, and at the end of, the reporting period.

Investment performance for 4 months ended 31 July 2018:

3.9 Investment rates available in the market have continued at low levels, although there was an increase in the Bank of England Base rate shortly after the date of this report from 0.50% to 0.75% in August 2018, which will have a positive effect on investment returns.

The ***average*** level of funds available for investment purposes up to 31 July 2018 was £21.4m. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and funding of the Capital Programme.

3.10 Table 1 shows the investment position as at 31 July 2018 shows:-

Investment Amount £	**Interest Budget £**	**Interest Actual £**	**Variance £**	**Annualised rate of return**
12,447,566	14,000	26,537	12,537	0.37%
Rate Benchmarking	**Overnight**	**7-day**	**1-month**	**3-month**
Average LIBOR rates Mar - Jul	0.5%	0.5%	0.54%	0.7%

The Council is currently ahead of target, and is forecast to be approximately £90k above budget at the end of the year. The cash balances are in line with expectations; therefore, the increase is attributed to changes in market rates associated with the increase in base rates.

The Council’s cash investments at the report date were held exclusively in money market funds primarily for liquidity purposes. The LIBOR rates averaged from the beginning of March to the end of July show that our investment return is within 0.13% of the overnight rate.

A full list of current investments is shown at exempt Appendix 1.

Borrowing performance for 4 months ended 31 July 2018:

3.11 The Council commenced external borrowing in April 2017 to fund its capital programme, and had total debt of £91.5m at the report date. Just over 50% of the current debt is at fixed rate for the medium-long term from the Public Works Loan Board (PWLB), with the remainder short term variable rate from other local authorities. As borrowing will increase further, and the prospect of rate increases grows, we may seek to take a higher proportion of the debt at long term fixed rates. This may cost more in the short term but will provide certainty of cost and provide savings in the longer term.

3.12 Table 2 shows the borrowing position as at 31 July 2018 shows:-

Borrowing Amount £	**Interest Budget £**	**Interest Actual £**	**Variance £**	**Annualised interest rate £**
91,500,000	691,333	398,506	292,827	1.17%
Borrowing Benchmarking	**3-year**	**5-year**	**10-year**	**20-year**
Average PWLB Maturity rate Mar - Jul	1.84%	2.04%	2.46%	2.82%

Interest for the full year is forecast to be significantly under budget, due in part to how the borrowing terms have been structured, but is dependent upon timings and borrowing requirements of capital projects (e.g. CQ2 development).

The average term of the current portfolio of borrowing is 4 years. The annualised interest rate above shows that we compare favourably to both the 3- and 5-year PWLB rates published on 31 July 2018.

3.13 **Non-treasury investment activity.**

The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Authority. This is replicated in MHCLG's Investment Guidance, in which the definition of investments is further broadened to also include all such assets held partially to generate a profit.

As at the report date, the Council holds £62.3m of investments in the form of shares in and loans to subsidiary companies (Graven Hill and Crown House)

These non-treasury investments generate or are expected to generate a higher rate of return (average 7.5%) than earned on treasury investments, but this reflects the additional risks to the Council of holding such investments.

3.14 Arlingclose provided a report for the quarter ending 30 June 2018. The highlights of which are:

Economic background

- UK Consumer Price Inflation (CPI) index fell over the quarter and the data released for June showed CPI at 2.4%, a 12-month low
- The most recent labour market data for April 2018 showed the unemployment rate at 4.2%, a low last seen in 1975.
- Real wages (i.e. adjusted for inflation) grew only by 0.4%, a marginal increase unlikely to have had much effect for households
- Q1 GDP data revised in May showed economic activity slowing to 0.2%
- Fears rose of a global trade war on the announcement of the Trump

Administration implementing tariffs on $200bn of imports, and implementation of retaliatory tariffs sparked a sell-off in global equity markets, with the major equity global indices falling.
- Very little progress was made in negotiating post-Brexit trading arrangements, extending the period of uncertainty.

Financial markets:
- Gilt yields displayed marked volatility during the quarter, particularly following Italy's political crisis in late May
- The yield on the 5-year benchmark gilt fell from 1.13% to 1.04% during the quarter, the 10-year gilt fell from 1.36% to 1.28% and the yield on the 20-year gilt rose marginally from 1.71% to 1.72%
- Money markets rates remained low: 1-month, 3-month and 12-month LIBID rates averaged 0.38%, 0.55% and 0.84% in the quarter respectively.

Credit background:
- UK bank credit default swaps rose marginally over the quarter, but the overall level was still low against historic averages
- Moody's downgraded Barclays Bank Plc's long-term rating to A2 from A1 following its restructure to be compliant with UK bank ring-fencing requirements coming into effect in 2019
- Moody's also downgraded Royal Bank of Scotland plc's (RBS plc) long-term ratings to Baa2 from A3 on its view that the credit metrics will become weaker and less diversified and the main functions of the bank would be in higher risk activities.
- Moody's and Fitch upgraded the long-term ratings of NatWest Bank and Ulster Bank on the view that their credit profiles are expected to improve following ring-fencing
- S&P revised the Royal Bank of Canada's outlook to stable from negative whilst affirming the long-term rating at AA-
- Fitch revised the Commonwealth Bank of Australia's outlook to negative from stable, whilst affirming the bank's long-term rating at AA-

3.15 **Outlook for the remainder of 2018/19**

Arlingclose's central case is for the Bank Rate is to rise once in 2018 and twice more in 2019. The MPC has a definite bias towards tighter monetary policy. While policymakers are wary of domestic inflationary pressures over the next two years, it is believed that the MPC members consider both that ultra-low interest rates result in other economic problems, and that a higher Bank Rate will be a more effective weapon should downside Brexit risks crystallise. Arlingclose's bank rate forecast is found in Table 3 below.

Table 3 Bank Rate Forecast

	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21
Official Bank Rate													
Upside risk	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Arlingclose Central Case	0.50	0.75	0.75	1.00	1.00	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25
Downside risk	0.00	0.25	0.25	0.50	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75

3.16 Arlingclose's view is that the UK economy still faces a challenging outlook as the minority government continues to negotiate the country's exit from the European Union. Central bank actions and geopolitical risks, such as prospective trade wars, have and will continue to produce significant volatility in financial markets, including bond markets.

4.0 Conclusion and Reasons for Recommendations

4.1 This report details the Treasury Performance for the Council for the period ending 31 July 2018.

5.0 Consultation

None

6.0 Alternative Options and Reasons for Rejection

6.1 The following alternative options have been identified and rejected for the reasons as set out below.

Option 1: To request further information on the performance reported.

7.0 Implications

Financial and Resource Implications

7.1 There are no financial implications arising directly from any outcome of this report.

Comments checked by:
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Legal Implications

7.2 There are no legal implications arising directly from any outcome of this report.

Comments checked by:
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Risk Management Implications

7.3 It is essential that this report is considered by the Audit Committee as it demonstrates that the risk of not complying with the Council's Treasury Management Policy has been avoided

Comments checked by:
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Equality and Diversity

7.4 There are no equality and diversity implications from this report.

Comments checked by:
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8.0 Decision Information

Wards Affected

All wards are affected

Links to Corporate Plan and Policy Framework

Links to all areas of Corporate Plan

Lead Councillor

None

Document Information

Appendix No	Title
Appendix 1 - EXEMPT	Schedule of In-house investments.
Background Papers	
None	
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