Cherwell District Council

Account, Audit and Risk Committee

13 March 2019

Treasury Management Report – January 2019

Report of the Executive Director: Finance and Governance (Interim)

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:

To note the contents of the January 2019 Treasury Management Report.

2.0 Introduction

2.1 In 2013 the Council adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code) which requires the Council to approve treasury management semi-annual and annual reports.

2.2 The Council's treasury management strategy for 2018/19 was approved at a meeting on 26 February 2018. The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk is therefore central to the Council's treasury management strategy.

2.3 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; the local authority specific Guidance Notes for the Codes were published in July 2018. In England MHCLG published its revised Investment Guidance which came into effect from April 2018.

2.4 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 Council's Capital Strategy, complying with CIPFA's requirement, was approved by full Council on 25 February 2019.

3.0 Report Details

2018/19 Performance

3.1 As at the end of January 2019 the Council had borrowing of £90.5m and investments of £11.4m of funds managed in-house – a net borrowing position of £79.1m.

Appendix 1 details the schedule of borrowing and investments as at 31 January 2019.

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 Council's main investment objective, followed by liquidity of capital, and then by yield. This has been maintained by following the Council'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 Council'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 10 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 10 months ended 31 January 2019:

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 from 0.50% to 0.75% in August 2018, which has had a positive effect on investment returns.
The ***average*** level of funds available for investment purposes up to 31 January 2019 was £18.5m. 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 January 2019:

Investment Amount £	Interest Budget £	Interest Actual £	Variance £	Annualised rate of return
12,369,852	35,000	71,833	36,833	0.47%
Rate Benchmarking	**Overnight**	**7-day**	**1-month**	
Average LIBOR rates	0.60%	0.62%	0.65%	

Interest receivable is currently ahead of target, and is forecast to be approximately £88k above budget at the end of the year. This is attributed to slightly higher than expected cash balances and changes in market rates associated with the increase in base rates.

The Council’s cash investments during the reporting period were held primarily for liquidity purposes in short-term money market funds and deposits, which generate sub-LIBOR returns.

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

Borrowing performance for 10 months ended 31 January 2019:

3.11 The Council commenced external borrowing in April 2017 to fund its capital programme, and had total debt of £90.5m at the report date; 45% 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 remains, 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 January 2019:

Borrowing Amount £	**Interest Budget £**	**Interest Actual £**	**Variance £**	**Annualised interest rate £**
90,500,000	1,728,667	1,077,502	651,164	1.38%
Borrowing Benchmarking	**3-year**	**5-year**	**10-year**	**20-year**
Average PWLB Maturity rate	1.85%	2.02%	2.43%	2.84%

Interest payable for the full year is forecast to remain significantly under budget, due in part to how the borrowing terms have been structured, but also due to lower than expected drawdowns from Graven Hill and cashflow updates on the CQ2 development.

The average term of the current borrowing portfolio is 6 years. The annualised interest rate above shows that we compare favourably to average PWLB rates for all durations for the reporting period.

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 Council. 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 £65.9m of investments in the form of shares (£22.8m) and loans (£43.1m) to subsidiary companies (Graven Hill and Crown House).

The loans elements of these non-treasury investments generate, or are expected to generate, a higher rate of return (average 7%) 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 31 December 2018. The highlights of which are:

Economic background:

- Oil prices fell back sharply by 25% to just over $60 in December.
- UK Consumer Price Inflation (CPI) for November was up 2.3% year/year.
- The most recent labour market data for the three months to October 2018 showed the unemployment rate remained at 4.1% while the employment rate of 75.7% was the joint-highest estimate since comparable estimates began in 1971.
- The 3-month average annual growth rate for pay excluding bonuses was 3.3% as wages continue to rise steadily and provide some pull on general inflation. Adjusted for inflation, real wages grew by

1.0%, a level likely to only have a modest impact on consumer spending.

- At 1.5%, annual GDP growth continues to remain below trend.
- With less than three months until Article 50 expires on 29th March 2019, the ongoing uncertainty continues to weigh on sterling and UK markets.

Financial markets:

- Investors wrestled with a range of global concerns: an economic slowdown in China, rising trade tensions between the US and China, a sharply lower oi price, slowing Euro area output and, of course, the ongoing uncertainty surrounding Brexit.
- Gilt yields continued to display significant volatility over the period on the back of ongoing economic and political uncertainty in the UK and Europe. After rising to 1.30% in October, gilts regained their safe-haven status in December - the 5-year benchmark gilt yield fell as low as 0.82% and there were similar falls in the 10-year and 20-year gilts over the same period dropping from 1.59% to 1.06% and from 2.05% to 1.62%.
- The higher Bank Rate continued to push up money markets rates. 1-month, 3-month and 12-month LIBID rates averaged 0.58%, 0.76% and 1.03% respectively over the period.

Credit background:

- Credit Default Swap (CDS) spreads drifted up over the period, reflecting the ongoing uncertainty around Brexit but continuing to remain low in historical terms.
- The ringfencing of the big four UK banks (Barclays, Bank of Scotland/Lloyds, HSBC and RBS/Natwest Bank plc) is complete and the transfer of their business lines into retail (ringfenced) and investment banking (non-ringfenced) continues prior to starting trading as separate entities from 1st January 2019.
- The Bank of England released its latest report on bank stress testing, illustrating that all entities tested were deemed to have passed the test once the levels of capital and potential mitigating actions presumed to be taken by management were factored in. The BoE did not require any bank to raise additional capital.

Outlook for the remainder of 2018/19

Having raised rates by 0.25% in November to 0.75%, the Bank of England's Monetary Policy Committee (MPC) has maintained expectations of a slow rise in interest rates over the forecast horizon. The MPC has a bias towards tighter monetary policy as its members consider that tight labour markets will prompt inflationary pressure in the future, ultra-low interest rates result in other economic problems, and higher Bank Rate will be a more effective policy weapon if downside risks to growth crystallise.

Arlingclose's central case is for Bank Rate to rise twice in 2019, after the UK exits the EU. However, recent events around Brexit have dampened interest rate expectations and the risks are weighted to the downside. The potential for severe economic outcomes has increased following the poor reception of the Withdrawal Agreement by MPs. The Bank of England will hold at or reduce interest rates from current levels if serious Brexit risks materialise.

	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Average
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	**0.17**
Arlingclose Central Case	**0.75**	**0.75**	**1.00**	**1.00**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.13**
Downside risk	0.00	-0.50	-0.75	-0.75	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	**-0.85**

Gilt yields have remained at low levels. Arlingclose expects some upward movement from current level but a projected weak economic outlook and volatility arising from both economic and political events will continue to offer borrowing opportunities.

4.0 Conclusion and Reasons for Recommendations

4.1 This report details the Treasury Performance for the Council for the period ending 31 January 2019.

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.

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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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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	Schedule of In-house investments - EXEMPT
Background Papers	
None	
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