

# **Cherwell District Council**

## **Accounts, Audit and Risk Committee**

**21 November 2018**

### **Treasury Management Report – October 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 October 2018 Treasury Management Report.

#### **2.0 Introduction**

- 2.1 As part of the investment strategy and governance arrangements, this committee considers the investment and borrowing 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. MHCLG published its revised Investment Guidance which came into effect from April 2018.
- 2.3 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 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 7 months of 2018/19.

### **3.0 Report Details**

#### **Summary Position**

- 3.1 As at the end of October 2018 the Council had borrowing of £87m and investments of £12m. A net borrowing position of £75m.

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

- 3.6 New borrowing has been kept to a minimum, whilst options for securing lower rates for longer term borrowing are reviewed. This strategy is enabling 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 has been taken.
- 3.8 All treasury management activities undertaken during the first 7 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 (see 3.11 and 3.14 below).

**Investment performance for 7 months ended 31 October 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 from 0.50% to 0.75% in August 2018, which will have a positive effect on investment returns for the remainder of the year.  
The **average** level of funds available for investment purposes up to 31 October 2018 was £19.2m. 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 The table below shows the investment position as at 31 October 2018:

<b>Investment Amount £</b>	<b>Interest Budget £</b>	<b>Interest Actual £</b>	<b>Variance £</b>	<b>Annualised rate of return</b>	<b>Average rate of current investments</b>
11,599,190	24,500	45,301	20,801	0.41%	0.58%
<b>Rate Benchmarking</b>	<b>Overnight</b>	<b>7-day</b>	<b>1-month</b>		
Average LIBOR rates Apr-Oct’18	0.57%	0.58%	0.61%		

The Council is currently ahead of target, and is forecast to be approximately £30k 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 are held primarily for liquidity purposes and therefore only available for short term deposits in a restricted selection of instruments (money-markets, call accounts etc), which generate sub-LIBOR returns.

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

3.11 Compliance with investment limits is shown in the table below:

	2018/19 Maximum	31/10/18 Actual	2018/19 Limit	Complied?
Any single organisation, except the UK Government	£6.6m	£3.9m	£10m	Yes
UK Central Government	£28.0m	£3.2m	Unlimited	Yes
Any group of organisations under the same ownership	£6.6m	£3.9m	£10m per group	Yes
Any group of pooled funds under the same management	£6.6m	£3.9m	£10m per manager	Yes
Money Market Funds	£11.6m	£7.4	£15m in total	Yes

### **Borrowing performance for 7 months ended 31 October 2018:**

3.12 The Council commenced external borrowing in April 2017 to fund its capital programme, and had total debt of £86.5m at the report date. Just over 47% 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 savings in the longer term.

3.13 The table below shows the borrowing position as at 31 October 2018:

<b>Borrowing Amount £</b>	<b>Interest Budget £</b>	<b>Interest Actual £</b>	<b>Variance £</b>	<b>Annualised interest rate</b>	<b>Average rate of current loans</b>
86,500,000	1,210,069	748,221	461,848	1.33%	1.48%
<b>Borrowing Benchmarking</b>	<b>3-year</b>	<b>5-year</b>	<b>10-year</b>	<b>20-year</b>	
Average PWLB Maturity rate Apr-Oct'18	1.86%	2.05%	2.47%	2.84%	

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

A full list of current borrowing is shown at exempt Appendix 1

3.14 Compliance with the authorised limit and operational boundary for external debt is demonstrated in the table below:

	2018/19 Maximum	31/10/18 Actual	2018/19 Operational Boundary	2018/19 Authorised Limit	Complied?
Borrowing / Total debt	£116.5m	£86.5m	£205	£225m	Yes

### 3.15 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 £62m 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.

We watch markets and activity closely and monitor activity. We remain up to date and work closely with our advisors.

3.16 Arlingclose provided a report for the 6 months ending 30 September 2018. The highlights of which are:

#### Economic background:

- Oil prices rose by 23% over the six months to around \$82/barrel.
- UK Consumer Price Inflation (CPI) for August rose to 2.7% year/year
- The most recent labour market data for July 2018 showed the unemployment rate at 4%, its lowest since 1975.
- The 3-month average annual growth rate for regular pay, i.e. excluding bonuses, was 2.9%, however real wages (i.e. adjusted for inflation) grew only by 0.2%.
- Quarterly GDP growth in Q2 rebounded to 0.4%, however the detail showed much of the growth was attributed to an increase in inventories. Year/year GDP growth at 1.2% remains below trend.
- The Bank of England made a unanimous decision for a rate rise of 0.25% in August, taking Bank Rate to 0.75%.
- The escalating trade war between the US and China risks contributing to a slowdown in global economic activity and growth in 2019.
- The EU Withdrawal Bill narrowly made it through Parliament, but with just six months to go, neither the Withdrawal Agreement between the UK and the EU, nor its annex which will outline the shape of their future relationship have been finalised, extending the period of economic uncertainty.

#### Financial markets:

- The 5-year benchmark gilt only rose marginally from 1.13% to 1.16%. There was a larger increase in 10-year gilt yields from 1.37% to 1.57% and in the 20-year gilt yield from 1.74% to 1.89%.
- The increase in Bank Rate resulted in higher money markets rates. 1-month, 3-month and 12-month LIBID rates averaged 0.56%, 0.70% and 0.95% respectively over the period.

#### Credit background:

- The ringfencing of the big four UK banks - Barclays, Bank of Scotland/Lloyds, HSBC and RBS/Natwest Bank plc - is complete, the transfer of their business lines into retail (ringfenced) and investment banking (non-ringfenced) is progressing and will need to be completed by the end of 2018.
- Our treasury advisor Arlingclose will henceforth provide ratings which are specific to retail or investment banks, rather than provide general issuer credit ratings.

### 3.17 Outlook for the remainder of 2018/19

Having raised policy rates in August 2018 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 definite bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly. While policymakers are wary of domestic inflationary pressures over the next two years, it is believed that the MPC members consider both that (a) ultra-low interest rates result in other economic problems, and that (b) higher Bank Rate will be a more effective weapon should downside Brexit risks crystallise and cuts are required.

Arlingclose's central case is for Bank Rate to rise twice in 2019. The risks are weighted to the downside.

	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21
<b>Official Bank Rate</b>													
<b>Upside risk</b>	0.00	0.00	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25
<b>Arlingclose Central Case</b>	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
<b>Downside risk</b>	0.00	0.00	0.50	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75

3.18 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 October 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. This will be managed as part of the service operational risk register.

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	CDC Schedule of borrowing and investments at 31 October 2018
<b>Background Papers</b>	
None	
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