County Council

6 December 2017

Mid-Year Review Report on Treasury Management for the period to 30 September 2017

Report of Corporate Management Team
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Purpose of the Report

1 The purpose of this report is to provide information on the treasury management mid-year position for 2017/18 and seek approval of a revision to the Council's Investment Strategy.

Background

2 Treasury management is defined as 'the management of the local authority's investments and cash flows, its banking, money market and capital market transactions, the effective control of the risks associated with those activities and the pursuit of optimum performance consistent with those risks'.

3 The Council operates a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

4 The second main function of the treasury management service is the funding of the Council's capital programme. The capital programme provides a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending requirements. The management of longer term cash may involve arranging long or short term loans, utilising longer term cash flow surpluses and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

5 The Council adopts the latest CIPFA Code of Practice on Treasury Management (the Code) which is regarded as best practice in ensuring adequate monitoring of the Council's capital expenditure plans and its Prudential Indicators (PIs). This requires that Members agree the following reports, as a minimum:

(a) an annual Treasury Management Strategy in advance of the year (reported to the County Council on 22 February 2017 in respect of the 2017/18 financial year);

(b) an annual review following the end of the year describing the activity compared to the strategy (reported to the County Council on 20 September 2017 in respect of the 2016/17 financial year);

(c) a mid-year Treasury Management Review Report (this report covering 6 months of the 2017/18 financial year).

6 This mid-year report has been prepared in accordance with the Code and includes:

(a) a review of the Treasury Management Strategy Statement and Annual Investment Strategy;

(b) a review of the Council's capital expenditure (prudential indicators);

(c) a review of the Council's investment portfolio for 2017/18;

(d) a review of the Council's borrowing strategy for 2017/18;

(e) a review of compliance with Treasury and Prudential Limits for 2017/18.

Treasury Management Statement and Investment Strategy Update

7 The Annual Treasury Management Statement for 2017/18 was approved by the Council on 22 February 2017.

8 It is recommended that revisions be made to the Investment Strategy. The proposed changes and rationale are detailed in paragraphs 27 to 28.

Capital Expenditure

9 The following table shows the revised estimates for capital expenditure in 2017/18 and the changes since the capital programme was agreed by Council.

Capital Expenditure by Service	**2017/18 Estimate agreed by Council in Feb 2017 (£ million)**	**2017/18 Approved Revisions (£ million)**	**2017/18 Revised Estimate (£ million)**
Adults and Health	0.526	(0.206)	0.320
Children and Young People's Service	12.007	16.981	28.988
Regeneration and Local Services	83.609	6.470	90.079
Resources	10.435	6.393	16.828
Transformation and Partnerships	3.167	1.343	4.510
Total Capital Expenditure by Service	**109.744**	**30.981**	**140.725**

10 Taking into account re-profiling from the 2016/17 capital programme, additional approved expenditure funded from grants, capital receipts and reserves and re-profiling into future years, the revised capital expenditure budget for the General Fund is £140.725 million.

11 In addition to the capital expenditure, shown in the table above, a leasing budget of £10.207 million was agreed by Full Council in February 2017, which will be revised to £8.949 million to reflect re-profiling from 2017/18 into future years.

12 Further details on the capital programme can be found in the 15 November 2017 Cabinet report 'Quarter 2 Forecast of Revenue and Capital Outturn 2017/18 for the General Fund – Period to 30 September 2017'.

Financing of Capital Expenditure

13 The following table draws together the capital expenditure plans, highlighting the expected financing arrangements in 2017/18, to determine the underlying borrowing need.

Capital Expenditure	**2017/18 Original Estimate (£ million)**	**2017/18 Revised Estimate (£ million)**
Capital Expenditure by Service	109.744	140.725
Leasing	10.207	8.949
Financed by:		
Capital receipts	17.700	17.832
Capital grants	44.726	55.610
Revenue and Reserves	4.935	4.241
Leasing financing	10.207	8.949
Total Financing	77.568	86.632
Borrowing Need	**42.383**	**63.042**

14 Following approval of the 2017/18 capital programme in February 2017, additional capital grants have been received and additional earmarked capital receipts and revenue and reserves have been allocated to finance the capital programme.

15 As a result of the changes to the capital budget the underlying borrowing requirement has been revised upwards by £20.659 million to £63.042 million. The borrowing need increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR). This will be reduced in part by revenue charges for the repayment of debt which is known as the Minimum Revenue Provision (MRP).

Capital Financing Requirement

16 The Capital Financing Requirement (CFR) shows the council's underlying need to borrow for capital purposes. It is the total historical outstanding capital expenditure which has not yet been paid for from either revenue or capital resource. The CFR includes any other long term liabilities *e.g. PFI schemes and finance leases. Whilst these increase the CFR these investments are separately financed and do not require additional borrowing.

17 The objective is to keep external debt within sustainable and prudent limits and ensure that in the medium term, debt is only used for a capital purpose. This is undertaken by a comparison of the gross debt with the CFR. To ensure that, over the medium term, gross borrowing will only be for a capital purpose, borrowing should not, except in the short-term, exceed the CFR for the previous year plus the cumulative increases in CFR for 2017/18 to 2019/20. The Council has complied with this requirement as shown in the following table, which shows gross borrowing is less than the CFR:

	Position at 1 Apr 2017 (£ million)	**Position at 30 Sep 2017 (£ million)**
Gross Borrowing*	303.510	303.500
CFR as at 1.4.17	431.641	431.641
Increase in CFR 2017/18	47.173	47.173
Increase in CFR 2018/19	10.841	10.841
Increase in CFR 2019/20	5.114	5.114
CFR comparator for gross borrowing	494.769	494.769

*includes PFI and finance lease liabilities on balance sheet

18 The revised forecast CFR position for the end of 2017/18 is £478.814 million, which compares with the original estimate of £501.181 million. The difference is due to reprofiling of the capital programme into future years and use of additional resources to finance the capital programme such as grants, contributions and revenue contributions.

19 The Authorised Limit is the council's "affordable borrowing limit" required by section 3(1) of the Local Government Act 2003. This represents the limit beyond which borrowing / external debt is prohibited. The limit reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable.

20 The Operational Boundary is the level of borrowing that the Council could reach during the year. It is not a limit and actual borrowing could vary around this boundary for short times during the year. It acts as an indicator to ensure that the Council's Authorised Limit is not breached. The table below shows that borrowing has remained within the Authorised Limit and Operational Boundary during 2017/18.

	2017/18 Approved Limit (£ million)
Authorised Limit	555.000
Operational Boundary	502.000
Maximum gross borrowing position during 2017/18*	303.510
Actual gross borrowing position as at 30 September 2017	303.500

*includes PFI and finance lease liabilities on balance sheet

Borrowing Strategy

21 The CFR indicates the requirement for the Council to borrow to support its capital activities. This borrowing can be in the form of external sources (e.g. PWLB) or internal resources (e.g. use of reserves and working capital).

22 The Corporate Director of Resources, under delegated powers, will adopt the most appropriate form of borrowing depending on the prevailing interest rates at the time.

23 Due to the overall financial position of the Council, no new borrowing has been raised during the first six months of 2017/18.

24 The overall borrowing position at 30 September 2017 was £255.623 million (excluding PFI and finance lease liabilities). There are three debt related treasury activity limits which are designed to manage risk and reduce impact of adverse movement in interest rates. These are the upper limit for both fixed and variable interest rate exposure and the maturity structure of fixed interest rate borrowing. The position at the half-year stage compared with the parameters set out in the 2017/18 strategy is shown below.

	Upper Limits	Position at 30 September 2017
1 Upper limit for FIXED interest rate exposure	100%	90.13%
2 Upper limit for VARIABLE interest rate exposure	70%	9.87%
3 Maturity structure of FIXED interest rate borrowing		
less than 1 year	20%	0%
between 1 and 2 years	40%	4%
between 2 and 5 years	60%	9%
between 5 and 10 years	80%	26%
10 years or more	100%	61%

Debt Rescheduling

25 Debt rescheduling opportunities are very limited in the current economic climate given the consequent structure of interest rates and following the increase in the margin added to gilt yields which has impacted PWLB new borrowing rates since October 2010. Therefore no debt rescheduling has been undertaken this year.

Investment Portfolio

26 In accordance with the Code, 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.

27 It is proposed to amend the Investment Strategy to:

(a) facilitate a more balanced approach to investing by diversifying the Council's investment portfolio, spreading the investment risk and maximising investment returns (whilst having regard to security and liquidity);

(b) invest in businesses within County Durham in order to encourage regeneration and economic development in the area.

28 The proposed changes are to:

(a) increase the monetary limit for equity shareholdings up to £30 million in total (from £20 million);

(b) £15 million in an individual business (from £11 million);

(c) allow investment in property funds of not more than £50 million in total and £25 million in an individual fund (from £10 million and £5 million respectively).

29 Any new investments will only be agreed after appropriate due diligence has been carried out.

30 A revised list of investments which the Council will be permitted to use, if Members are in agreement, is attached as Appendix 2.

31 Members are recommended to approve the aforementioned revisions to the Investment Strategy for 2017/18.

32 The following table details the Council's equity shareholdings as at 31 March 2017 and 30 September 2017.

Company	31 Mar 2017	30 Sep 2017
	£ million	£ million
Atom Bank	0.152	0.152
Chapter Homes	1.715	1.715
Durham County Cricket Club	0.000	3.740
Forrest Park	1.000	1.000
Newcastle International Airport Ltd	10.558	10.558
Polyphotonix	0.300	0.300
Total	**13.725**	**17.465**

33 The original budgeted investment return for investment income 2017/18 was £1.700 million, however it is now expected that this will be exceeded by around £0.620 million. This is mainly due to higher than forecast level of returns on short term investments and council commercial activities.

Investment Risk Benchmarking

34 All of the Council's investment activity has remained within the benchmarks for managing investment risk which were included in the Annual Treasury Management Strategy.

35 The following table compares the actual position for the first six months of 2017/18 against the previously agreed benchmarks.

Investment Risk	Measured by	Benchmark	Actual position 30 September 2017
Security	% of historic risk of default	0.08%	0.012%
Liquidity	Weighted average life to maturity	6 months (183 days) average 9 months (274 days) maximum	224 days average
Yield	Internal returns above the 7 day LIBID rate	0.112%	0.53%

Investment Counterparty Criteria

36 The current investment counterparty criteria selection as approved in the Annual Treasury Management Strategy is meeting the requirements of the treasury management function.

37 At 30 September 2017 the Council held investments, with a maturity of no longer than one year, totalling £149.647 million. The following table provides a breakdown of the type of financial institution within which these investments were held at 30 September 2017, split by the maturity period.

Sector	0-3 months	3-6 months	6-12 months
	£m	£m	£m
Banks	29.040	59.876	29.938
Building Societies			25.661
Central Government/Local Authorities	5.132		
Local Authorities			
Money Market Funds			
TOTAL	**34.172**	**59.876**	**55.599**

Icelandic Bank Deposits

38 Prior to Local Government Review, one former District Council had £7 million deposited across the Icelandic banks Glitnir Bank hf (£4 million), Landsbanki (£2 million) and Kaupthing Singer and Friedlander Ltd (£1 million), which all collapsed financially in October 2008. The County Council inherited this position in April 2009.

39 The only outstanding balance as at 31 March 2017 is in relation to the investment with Kaupthing Singer and Friedlander Ltd (KSF). All monies with KSF are currently subject to the respective administration and receivership processes. As at 30 September 2017, 85.15% of the outstanding balance has been repaid to the Council; 86.25%-87.25% recovery is ultimately anticipated.

Recommendations and Reasons

40 It is recommended that Council:

(a) approve the proposed changes to the Treasury Management Strategy for 2017/18;

(b) note the contents of the mid-year review report for 2017/18.

Background papers

- 22 February 2017 – County Council – Appendix 12: Durham County Council Annual Treasury Management Strategy of the Medium Term Financial Plan, 2017/18 – 2019/20 and Revenue and Capital Budget 2017/18.
- County Council – 20 September 2017 – Treasury Management Outturn 2016/17.

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Appendix 1: Implications

Finance -

Details of the overall financing of the Council's anticipated capital expenditure, along with forecast borrowing and investment income returns are provided in the report.

Staffing –

None

Risk –

None

Equality and Diversity / Public Sector Equality Duty –

None

Accommodation -

None

Crime and Disorder -

None

Human Rights -

None

Consultation -

None

Procurement -

None

Disability issues -

None

Legal Implications –

None

Appendix 2: Revised List of Investment Instruments for use in 2017/18

Specified Investments

These investments are sterling investments of not more than one year maturity, or those which could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes. These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with:

- The UK Government (such as the Debt Management Account deposit facility);
- UK treasury bills or a gilt with less than one year to maturity;
- Term deposits with UK banks and building societies;
- A local authority, parish council or community council;
- Certificates of Deposit;
- Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency.

Non-specified Investments

These are investments which do not meet the specified criteria outlined above. The Council is required to examine non-specified investments in more detail. The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below.

Non-specified investments would include any sterling investments in the following:

- Gilt edged securities with a maturity of greater than one year.
  These are Government bonds and so provide the highest security of interest and the repayment of principal on maturity.
- The Council's own banker if it fails to meet the basic credit criteria.
  In this instance balances will be minimised as far as is possible.
- Equity shareholding in businesses of not more than £30 million in total, and £15 million in any one company.
  This will be after undertaking significant due diligence checks only. It will facilitate a more balanced approach to investing by diversifying the investment portfolio and reducing concentration risk.
- Local businesses, in order to encourage regeneration and economic development in the area.
  Any new investments will only be agreed after significant due diligence checks have been carried out.
- Property funds of not more than £50 million in total and £25 million in an individual fund.