Cabinet

14 November 2018

Mid-Year Review Report on Treasury Management for the period to 30 September 2018

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 2018/19.

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, with a main aim of providing sufficient liquidity, ahead of the achievement of the best possible investment returns.

4 The second main function of the treasury management service is to arrange the funding of the Council's capital programme. The capital programme provides a guide to the borrowing need of the Council, and there needs to be longer term cash flow planning to ensure capital spending requirements can be met. The management of longer term cash may involve arranging long or short term loans, utilising longer term cash flow surpluses and, occasionally, debt restructuring 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 21 February 2018 for the 2018/19 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 19 September 2018 in respect of the 2017/18 financial year);

(c) a mid-year Treasury Management Review report, covering the first six months of this financial year, to 30 September 2018 (this report);

6 This mid-year report provides a summary of the following:

(a) summary treasury position;

(b) borrowing activity;

(c) investment activity;

(d) treasury management indicators;

(e) prudential indicators;

Summary Treasury Position

7 The Council's debt and investment position is organised to ensure adequate liquidity for revenue and capital activities, security for investments, and to manage risks within all treasury management activities.

8 At the beginning and mid-year point of 2018/19 the Council's treasury position (excluding borrowing by finance leases) was as follows:

	31.03.18	**Rate /Return**	**Average Life**	**30.09.18**	**Rate /Return**	**Average Life**
	£ million	**%**	**years**	**£ million**	**%**	**years**
Total Debt	291	3.88	17.61	291	3.74	18.48
Total Investments	172	0.56	0.3	212	0.87	0.63
Net Debt	119			79		

9 As at 30 September 2018, the Council had £291 million of borrowing and £212 million of investments.

Borrowing Activity

9 At 30 September 2018, the Council held £290.602 million of loans, a decrease of £0.011 million from the start of the year. The mid-year borrowing position and the change since the start of the year is shown in the table below:

	31.3.18 Balance £ million	In-year Movement £ million	30.9.18 Balance £ million	Average Rate %	30.9.18 Average Life years
Public Works Loan Board	238.979	(0.001)	238.978	3.60%	16.5
Private Sector	51.420	(0.003)	51.417	4.41%	27.7
Pension Fund	0.214	(0.007)	0.207	8.01%	9.5
Total borrowing	**290.613**	**(0.011)**	**290.602**		

11 The Council's chief objective when borrowing has been to strike an appropriate risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required.

12 During the period there was a £10m PWLB loan that matured in September 2018 at an interest rate of 2.72%. To take advantage of historically low rates of interest, new borrowing of £10 million was raised during the first half-year with details in the following table.

Lender	Principal £ million	Interest Rate %	Start Date	Length
PWLB	10.00	2.31	31/05/2018	40 years
Total	**10.00**			

13 Affordability and the "cost of carry", the gap between the interest rates on borrowings and the interest rates achieved on investments, continued to be important influences on the Council's borrowing strategy. During the first half-year the Council's Treasury Management advisors, Link Asset Services, identified that there was a strong possibility that interest rates would have increased by the time the Council next needed to undertake significant borrowing to support the capital programme. An options appraisal was undertaken to compare the potential borrowing alternatives that were identified:

(a) to secure future borrowing at fixed, historically low, rates with no cost of carry anticipated

(b) taking out PWLB loans at current rates and incurring costs of carry until they were needed.

14 The conclusion was that securing future borrowing at the following fixed rates was identified as the preferred option:

Loan Number	Deferred Period	Rate	Amount	Start Date	Maturity Date
Loan 1	1.5 years	2.733%	£20m	13/02/2020	13/02/2070
Loan 2	2.5 years	2.773%	£15m	15/02/2021	15/02/2071
Loan 3	3 years	2.793%	£15m	13/08/2021	13/08/2071
Loan 4	3.5 years	2.807%	£10m	15/02/2022	15/02/2072

15 This enabled the Council to make savings against the cost of carrying the loans if they had been taken out immediately at the prevailing PWLB rates.

16 No rescheduling was done during the year as the differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

Other Debt Activity / Long Term Liabilities

17 Although not classed as borrowing, the Council also raised £1.131 million of capital finance for replacement fleet vehicles and equipment via finance leases during the first half year to 30 September 2018. It is expected that a further £6.192m will be raised during the remainder of the year, giving total expected additional lease finance of £7.323 million.

Investment Activity

18 The Council has invested significant funds, representing monies received in advance of expenditure plus balances and reserves held. During the half-year to 30 September 2018, investment balances ranged between £171.8 million and £ 252.0 million.

19 As at 30 September 2018 the Council held investments totalling £211.820 million. The following table provides a breakdown of these investments split by the type of financial institution and maturity period.

Financial Institution	**0-3 months**	**3-6 months**	**6-12 months**	**Total**
	£ million			
Banks	4.312	34.495	68.990	107.797
Building Societies	-	-	-	-
Central Government	0.862	-	-	0.862
Other Local Authorities	4.312	13.798	63.384	81.494
Money Market Funds	21.667	-	-	21.667
Total	**31.153**	**48.293**	**132.374**	**211.820**
% of total	**15%**	**23%**	**62%**	

20 The Council's investment policy is governed by Ministry of Housing, Communities and Local Government (MHCLG) guidance, which has been implemented in the annual investment strategy approved by the Council on 21 February 2018. Both the CIPFA Code and government guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

21 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. The following table compares the actual position as at 30 September 2018 against the previously agreed benchmarks.

Investment Risk	Measured by	Benchmark	Actual position 30.9.2018
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	231 days average
Yield	Internal returns above the 7 day LIBID rate	0.44%	0.87%

Treasury Management Indicators

22 There are three debt related treasury activity limits which are designed to manage risk and reduce the impact of an adverse movement in interest rates.

Interest Rate Exposures: This indicator is set to control the Council's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of net principle invested was:

	30.9.18 Actual	30.9.18 Actual	2018/19 Limit	Complied
Upper limit on fixed interest rate exposure	£251.1m	86.4%	100%	✓
Upper limit on variable interest rate exposure	£39.5m	13.6%	70%	✓

Maturity Structure of Borrowing: This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing were:

	Lower Limit	Upper Limit	30.9.18 Actual	Complied
Under 12 months	0%	20%	0%	✓
12 months to 2 years	0%	40%	4%	✓
2 years to 5 years	0%	60%	7%	✓
5 years to 10 years	0%	80%	23%	✓
10 years and above	0%	100%	66%	✓

Principal Sums Invested for Periods Longer than 364 days: The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments:

	Limit	As at 30.9.18	Complied
Actual principal invested beyond one year	£75m	£0m	✓

Prudential Code Indicators

23 The Local Government Act 2003 requires the Council to have regard to the Chartered Institute of Public Finance and Accountancy's Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow.

24 The objective of the Prudential Code is to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Council has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

Capital Expenditure: The table below summarises planned capital expenditure and financing when the 2018/19 budget was set in February 2018 and compares it to the estimated position at 30 September 2018:

	2018/19 Original Estimate £ million	2018/19 Estimate at 30.9.18 £ million	Difference £ million
Capital Expenditure	**104.109**	**116.190**	**12.081**
Financed by:			
Capital grants and contributions	34.028	59.109	25.081
Revenue and reserves	13.006	46.135	33.129
Capital receipts	22.439	9.263	-13.176
Net financing need for the year	**34.636**	**1.683**	**-32.953**

Capital Financing Requirement (CFR): The CFR is a measure of the Council's underlying borrowing need for a capital purpose. The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). The forecast outturn position compared to the original estimate in February 2018 is set out in the table overleaf:

	2018/19 Original Estimate £ million	2018/19 Forecast at 30.9.18 £ million	Difference £ million
Total Capital Financing Requirement	**484.786**	**420.855**	**-63.832**

Forecast Debt: The Council's forecast outturn debt at 30 September 2018 is as follows	31.03.18 Actual £ million	2018/19 Forecast at 30.09.18 £ million	Difference £ million
Borrowing	290.613	290.602	**-0.011**
Finance leases	9.545	11.892	**2.347**
PFI liabilities	39.174	38.183	**-0.991**
Total Debt	**339.332**	**340.677**	**1.345**

Gross Debt and the Capital Financing Requirement: In order to ensure that over the medium term debt will only be for a capital purpose, the Council should ensure that debt does not, except in the short term, exceed the total of the capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence. The table below shows the forecast position as at 30 September 2018:

	2018/19 Estimate £ million	2018/19 Forecast at 30.09.18 £ million	Difference £ million
Total debt	347.460	340.677	**-6.783**
Capital financing requirement	484.786	420.855	**-63.931**
Headroom (Under Borrowed)	**-137.326**	**-80.178**	**-70.714**

Operational Boundary: This is the limit beyond which external borrowing is not normally expected to exceed. Periods where the actual position is either below or over the boundary is acceptable subject to the authorised limit not being breached.

Operational boundary	2018/19 Estimate £ million	2018/19 Actual as at 30.9.18 £ million	Complied
Borrowing	432.000	290.602	✓
Other long term liabilities	53.000	48.135	✓
TOTAL	**485.000**	**338.737**	✓

Authorised Limit for external borrowing: This represents a control on the maximum level of borrowing and is a statutory limit determined under section 3 (1) of the Local Government Act 2003. It reflects the level of external borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

Authorised limit	2018/19 Estimate £ million	2018/19 Actual as at 30.9.18 £ million	Complied
Borrowing	482.000	290.602	✓
Other long term liabilities	56.000	48.135	✓
TOTAL	**538.000**	**338.737**	✓

Actual and estimates of the ratio of financing costs to net revenue stream: This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

	2018/19 Estimate %	2018/19 Actual as at 30.9.18 %	Difference %
Ratio of financing costs to net revenue stream	7.67	7.07	-0.60

Recommendations and Reasons

25 Cabinet is asked to note the report.

Background Papers

a) 21 February 2018 – County Council – Appendix 11: Durham County Council 2018/19 Annual Treasury Management Strategy as part of the Medium Term Financial Plan, 2018/19 to 2021/22 and Revenue and Capital Budget 2018/19.

b) County Council – 19 September 2018 – Treasury Management Outturn 2017/18.

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Appendix 1: Implications

Finance

The report details the Council's cash management, loans and investment activity during 2018/98. The report also provides the overall financing of the Council's capital expenditure, along with borrowing and investment income returns.

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.