

# REPORT FOR DECISION

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| <b>DECISION OF:</b>                       | <b>CABINET<br/>OVERVIEW &amp; SCRUTINY COMMITTEE<br/>COUNCIL</b>  |
| <b>DATE:</b>                              | <b>14 NOVEMBER 2018<br/>22 NOVEMBER 2018<br/>28 NOVEMBER 2018</b>   |
| <b>SUBJECT:</b>                           | <b>TREASURY MANAGEMENT STRATEGY – MID YEAR<br/>REVIEW 2018/19</b>   |
| <b>REPORT FROM:</b>                       | <b>CABINET MEMBER FOR FINANCE &amp; HOUSING</b>   |
| <b>CONTACT OFFICER:</b>                   | <b>STEPHEN KENYON, INTERIM EXECUTIVE DIRECTOR<br/>OF RESOURCES AND REGULATION</b>   |
| <b>TYPE OF DECISION:</b>                  | <b>COUNCIL</b>  |
| <b>FREEDOM OF<br/>INFORMATION/STATUS:</b> | The report is within the public domain  |
| <b>SUMMARY:</b>                           | <p>This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:</p> <ul style="list-style-type: none"><li>• An economic update for the 2018/19 financial year to 30 September 2018;</li><li>• A review of the Treasury Management Strategy Statement and Annual Investment Strategy;</li><li>• The Council's capital expenditure, as set out in the Capital Strategy, and prudential indicators;</li><li>• A review of the Council's investment portfolio for 2018/19</li><li>• A review of the Council's borrowing strategy for 2018/19</li><li>• A review of any debt rescheduling undertaken during 2018/19</li><li>• A review of compliance with Treasury and Prudential Limits for 2018/19</li></ul> |
| <b>OPTIONS &amp;</b>                      | It is recommended that, in accordance with CIPFA's Code of Practice on Treasury Management, the report be noted.  |

|   |   |
|---|---|
| <b>RECOMMENDED OPTION</b>   |   |
| <b>IMPLICATIONS:</b>  |   |
| <b>Corporate Aims/Policy Framework:</b>   | Do the proposals accord with the Policy Framework?      Yes   |
| <b>Statement by the S151 Officer: Financial Implications and Risk Considerations:</b> | Treasury Management is an integral part of the Council's financial framework and it is essential that the correct strategy is adopted in order to ensure that best value is obtained from the Council's resources and that assets are safeguarded.  |
| <b>Statement by Interim Executive Director of Resources and Regulation:</b>           | There are no wider resource implications  |
| <b>Equality/Diversity implications:</b>   | No  |
| <b>Considered by Monitoring Officer:</b>  | The report complies with the Council's financial regulation 5.7. The Council is required by statute to set and maintain a balanced budget. Careful management of the finances in year allows the Council to achieve this and this report provides a means for Members to carefully monitor the situation.      JH |
| <b>Wards Affected:</b>  | All   |
| <b>Scrutiny Interest:</b>   | Overview & Scrutiny Committee   |

**TRACKING/PROCESS**

**DIRECTOR: STEVE KENYON**

| Chief Executive/<br>Strategic Leadership<br>Team | Cabinet<br>Member/Chair | Ward Members | Partners    |
|--|-------------------------|--------------|-------------|
| 14 November                                      | 14 November             | N/a          | N/a         |
| Scrutiny   |                         | Committee    | Council     |
| 22 November                                      |                         |              | 28 November |

## 1.0 BACKGROUND

1.1 In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued revised Prudential and Treasury Management Codes. As from 2019/20, all authorities will be required to prepare a Capital Strategy which is intended to provide the following:-

- A high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services,
- An overview of how the associated risk is managed,
- The implications for future financial sustainability.

A report setting out our Capital Strategy will be taken to Council before 31<sup>st</sup> March 2019.

1.2 The Council operates a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operations 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.

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

Accordingly, treasury management is defined as:-

"The management of the local authority's borrowing, 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".

1.2 This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017).

The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
3. Receipt by the full council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a **Mid-year Review Report** and an Annual Report (stewardship report) covering activities during the previous year.
4. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
5. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is: Overview & Scrutiny Committee.

1.3 This report fulfils the requirement to produce a mid-year review.

## 2.0 ECONOMIC UP-DATE (from Treasury Advisors)

### 2.1 Economic Performance to date

- 2.1.1 UK economic growth in the first half of 2018/19 was modest but sufficiently robust for the Monetary Policy Committee (MPC) to unanimously vote to increase the bank rate on 2<sup>nd</sup> August from 0.5% to 0.75%.
- 2.1.2 Growth is expected to be around 1.5% in 2018, but the Bank of England August Quarterly Inflation Report forecast that growth will increase to 1.8% in 2019.
- 2.1.3 The Consumer Price Index (CPI) measure of inflation rose unexpectedly from 2.4% in June to 2.7% in August, but is expected to fall back to the 2% inflation target over the next two years given minimal increases in the bank rate. The MPC has indicated Bank Rate would need to be in the region of 1.5% by March 2021 for inflation to stay on track.
- 2.1.4 Financial markets are currently pricing in the next increase in Bank Rate for second half of 2019.

### 2.2 Interest rate Forecasts and Outlook

- 2.2.1 The Council's treasury advisor, Link Asset Services, has provided the following forecast:

| Link Asset Services Interest Rate View |        |        |        |        |        |        |        |        |        |        |        |
|--|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
|  | Sep-18 | Dec-18 | Mar-19 | Jun-19 | Sep-19 | Dec-19 | Mar-20 | Jun-20 | Sep-20 | Dec-20 | Mar-21 |
| Bank Rate View                         | 0.75%  | 0.75%  | 0.75%  | 0.75%  | 1.00%  | 1.00%  | 1.00%  | 1.25%  | 1.25%  | 1.50%  | 1.50%  |
| 3 Month LIBID                          | 0.75%  | 0.80%  | 0.80%  | 0.90%  | 1.10%  | 1.10%  | 1.20%  | 1.40%  | 1.50%  | 1.60%  | 1.60%  |
| 6 Month LIBID                          | 0.85%  | 0.90%  | 0.90%  | 1.00%  | 1.20%  | 1.20%  | 1.30%  | 1.50%  | 1.60%  | 1.70%  | 1.70%  |
| 12 Month LIBID                         | 1.00%  | 1.00%  | 1.00%  | 1.10%  | 1.30%  | 1.30%  | 1.40%  | 1.60%  | 1.70%  | 1.80%  | 1.80%  |
| 5yr PWLB Rate                          | 2.00%  | 2.00%  | 2.10%  | 2.20%  | 2.20%  | 2.30%  | 2.30%  | 2.40%  | 2.50%  | 2.50%  | 2.60%  |
| 10yr PWLB Rate                         | 2.40%  | 2.50%  | 2.50%  | 2.60%  | 2.70%  | 2.70%  | 2.80%  | 2.90%  | 2.90%  | 3.00%  | 3.10%  |
| 25yr PWLB Rate                         | 2.80%  | 2.90%  | 3.00%  | 3.10%  | 3.10%  | 3.20%  | 3.30%  | 3.30%  | 3.40%  | 3.50%  | 3.50%  |
| 50yr PWLB Rate                         | 2.60%  | 2.70%  | 2.80%  | 2.90%  | 2.90%  | 3.00%  | 3.10%  | 3.10%  | 3.20%  | 3.30%  | 3.30%  |

Link Asset Services undertook do not think that the MPC will increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. They think the MPC is more likely to wait until August 2019, than May 2019, before the next increase, to be followed by further increases of 0.25% in May and November 2020 to reach 1.5%. However, the cautious pace of these limited increases is dependent on a reasonably orderly Brexit.

- 2.2.2 The overall balance of risks to economic recovery in the UK is neutral. The balance of risks to increases in Bank Rate and shorter term PWLB rates, are also even and are broadly dependent on how strong GDP growth is, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.

## 3.0 TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY UP-DATE

- 3.1 The Treasury Management Strategy Statement (TMSS) for 2018/19 was approved by the Council on 21 February 2018.

- 3.2 There are no policy changes to the TMSS; the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

#### 4.0 THE COUNCIL'S CAPITAL POSITION (PRUDENTIAL INDICATORS)

This part of the report is structured to update:

- The Council's capital expenditure plans;
- How these plans are being financed;
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity.

#### 4.1 Prudential Indicator for Capital Expenditure

This table shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the Budget

| <b>Capital Expenditure</b> | <b>2018/19<br/>Original<br/>Estimate<br/>£m</b> | <b>2018/19<br/>Revised<br/>Estimate<br/>£m</b> |
|----------------------------|---|--|
| <b>Non-HRA</b>             | 15.538  | 28.224   |
| <b>HRA</b>                 | 9.830   | 12.416   |
| <b>Total</b>               | <b>25.368</b>                                   | <b>40.640</b>                                  |

The increase of the revised estimate over the original estimate is due to slippage from 2017/18 of £28.398m offset by estimated project reprofiling to 2019/20 of £13.126m

#### 4.2 Changes to the Financing of the Capital Programme

The table below shows the main strategy elements of the capital expenditure plans. The borrowing requirement shown will increase the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

| <b>Capital Expenditure</b>       | <b>2018/19<br/>Original<br/>Estimate<br/>£m</b> | <b>2018/19<br/>Revised<br/>Estimate<br/>£m</b> |
|----------------------------------|---|--|
| <b>Total capital expenditure</b> | <b>25,368</b>                                   | <b>40,640</b>                                  |
| <b>Financed by:</b>              |   |  |
| <b>Capital receipts</b>          | <b>1,770</b>                                    | <b>5,096</b>                                   |
| <b>Capital grants</b>            | <b>10,018</b>                                   | <b>10,003</b>                                  |
| <b>Capital reserves</b>          |   |  |
| <b>Revenue</b>                   | <b>9,830</b>                                    | <b>13,266</b>                                  |
| <b>Total financing</b>           | <b>21,618</b>                                   | <b>28,365</b>                                  |
| <b>Borrowing requirement</b>     | <b>3,750</b>                                    | <b>12,275</b>                                  |

## 4.2 Changes to the Prudential Indicators for the Capital Financing Requirement, External Debt and the Operational Boundary

The table shows the CFR, which is the underlying external need to incur borrowing for a capital purpose. It also shows the expected debt position over the period, which is termed the Operational Boundary.

|  | <b>2018/19<br/>Original<br/>Estimate<br/>£m</b> | <b>2018/19<br/>Revised<br/>Estimate<br/>£m</b> |
|--|---|--|
| <b>Prudential Indicator - Capital Financing Requirement</b>            |   |  |
| CFR – non HRA  | 125.554   | 129.961  |
| CFR – HRA existing   | 40.531  | 40.531   |
| Housing Reform Settlement  | 78.253  | 78.253   |
| <b>Total CFR</b>   | <b>244.338</b>                                  | <b>248.745</b>                                 |
| <b>Prudential Indicator - External Debt / the Operational Boundary</b> |   |  |
| Borrowing  | 244.400   | 248.700  |
| Other long term liabilities  | 5.000   | 5.000  |
| <b>Total</b>   | <b>249.400</b>                                  | <b>253.700</b>                                 |

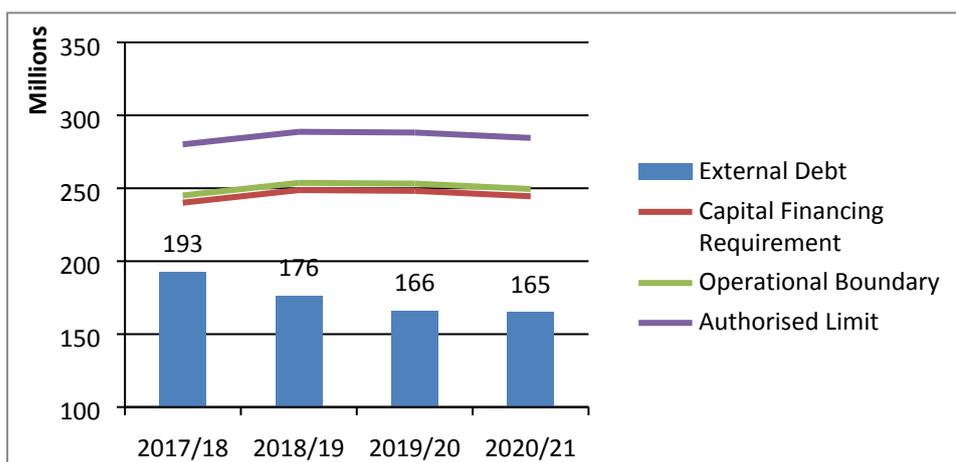
## 4.3 Limits to Borrowing Activity

- 4.3.1 The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2018/19 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.
- 4.3.2 The Interim Executive Director of Resources reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.
- 4.3.3 A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

|  | <b>2018/19</b> | <b>2018/19</b> |
|--|----------------|----------------|
|--|----------------|----------------|

| <b>Authorised Limit for External Debt</b> | <b>Original Indicator<br/>£m</b> | <b>Revised Indicator<br/>£m</b> |
|---|----------------------------------|---------------------------------|
| Borrowing                                 | 279.400                          | 283.700                         |
| Other long term liabilities               | 5.000                            | 5.000                           |
| <b>Total</b>                              | <b>284.400</b>                   | <b>288.700</b>                  |

4.3.4 The chart below shows the projected trend of the Council's Prudential Indicators.



## 5.0 INVESTMENT PORTFOLIO 2018/19

5.1 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. As set out in Section 2, it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low and in line with the 0.75% Bank Rate. The continuing potential for a re-emergence of a Eurozone sovereign debt crisis, and its impact on banks, prompts a low risk and short term strategy. Given this risk environment and the fact that increases in Bank Rate are likely to be gradual and unlikely to return to the levels seen in previous decades, investment returns are likely to remain low.

5.2 The Council held £4.8m of investments as at 30 September 2018 (£18.5m at 31 March 2018) and the investment portfolio yield for the first six months of the year is 0.61% against Link's suggested investment earnings rate for returns on investments placed, for periods up to three months in 2018/19, of 0.61%.

5.3 The investments held as at 30 September were:-

| <b>Type of Investment</b>                  | <b>£ Million</b> |
|--|------------------|
| Call Investments (Cash equivalents)        | 3.6              |
| Fixed Investments (Short term investments) | 1.2              |
| <b>Total</b>                               | <b>4.8</b>       |

5.4 The Interim Executive Director of Resources & Regulation confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2018/19.

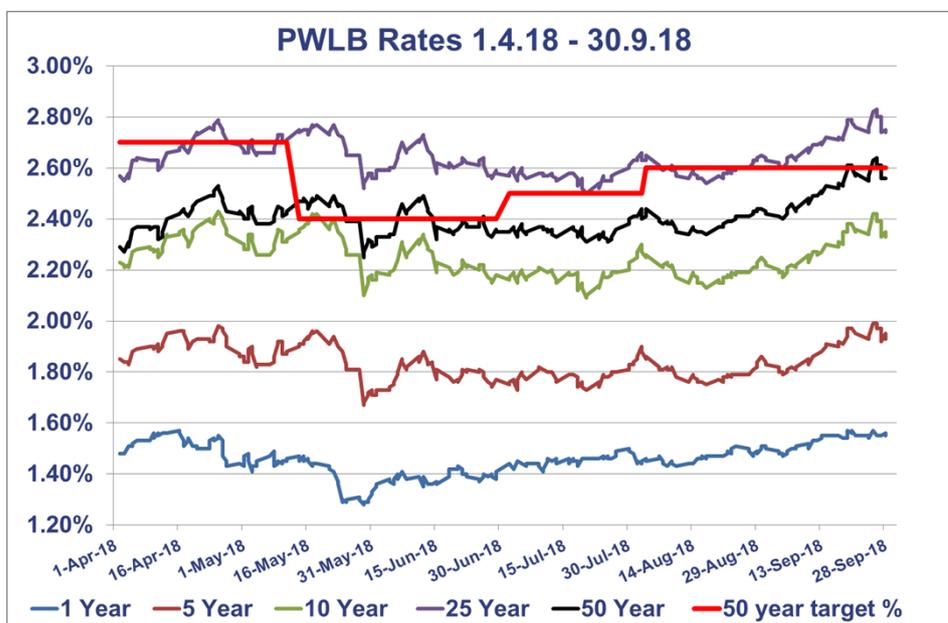
- 5.5 The Council's budgeted investment return for 2018/19 is £0.5m, and performance for the year to date is in line with the budget.
- 5.6 The Cabinet have approved a "Property Investment Strategy" which aims to increase investment income by investing in property rather than investing with financial institutions where returns are low at present. Additional borrowing may need to be undertaken to finance property acquisitions; each investment will be subject to a robust business case and also non-financial factors (e.g. ethical stance) will be considered.

## 6.0 BORROWING

- 6.1 The Council's capital financing requirement (CFR) for 2018/19 is £248.7m. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions. The table below shows the Council has borrowings of £189.0m and has utilised £59.7m of cash flow funds in lieu of borrowing. This is a prudent and cost effective approach in the current economic climate but will require ongoing monitoring in the event that upside risk to gilt yields prevail.

|                                |              | 1 April 2018                 |                |              | 30 September 2018            |                |              |
|--------------------------------|--------------|------------------------------|----------------|--------------|------------------------------|----------------|--------------|
|                                |              | Principal                    |                | Avg.         | Principal                    |                | Avg.         |
|                                |              | £000                         | £000           | Rate         | £000                         | £000           | Rate         |
|                                |              | <b>Fixed rate funding</b>    |                |              | <b>Fixed rate funding</b>    |                |              |
|                                | PWLB Bury    | 131,453                      |                |              | 131,453                      |                |              |
|                                | PWLB Airport | 554                          |                |              | 550                          |                |              |
|                                | Market Bury  | 60,500                       | 192,507        |              | 48,500                       | 180,503        |              |
|                                |              | <b>Variable rate funding</b> |                |              | <b>Variable rate funding</b> |                |              |
|                                | PWLB Bury    |                              | 0              |              | 0                            |                |              |
|                                | Market Bury  |                              | 0              |              | 0                            | 0              |              |
| <b>Temporary Loans / Bonds</b> |              |                              | 2,003          |              | 8,500                        | 8,500          |              |
| <b>Total Debt</b>              |              |                              | <b>194,510</b> | <b>3.96%</b> |                              | <b>189,003</b> | <b>3.96%</b> |
| <b>Total Investments</b>       |              |                              | <b>21,250</b>  | <b>0.24%</b> |                              | <b>4,800</b>   | <b>0.61%</b> |

- 6.2 External borrowing of £8.5million has been undertaken from the market during the first 6 months of 2018/19. 5 short term temporary loans were taken to take advantage of low interest rates. The loans were required to replace 4 loans, totalling £12m, which matured in the first half of the year. Additional external borrowing will be required during the remainder of this financial year.
- 6.3 The graph below shows the movement in PWLB certainty rates for the first six months of the year to 30.09.17:



|         | 1 Year     | 5 Year     | 10 Year    | 25 Year    | 50 Year    |
|---------|------------|------------|------------|------------|------------|
| 3.4.18  | 1.48%      | 1.84%      | 2.22%      | 2.55%      | 2.27%      |
| 30.9.18 | 1.55%      | 1.93%      | 2.33%      | 2.74%      | 2.56%      |
| Low     | 1.28%      | 1.67%      | 2.09%      | 2.50%      | 2.25%      |
| Date    | 01/06/2018 | 29/05/2018 | 20/07/2018 | 20/07/2018 | 29/05/2018 |
| High    | 1.57%      | 1.99%      | 2.43%      | 2.83%      | 2.64%      |
| Date    | 17/04/2018 | 25/09/2018 | 25/04/2018 | 25/09/2018 | 25/09/2018 |
| Average | 1.46%      | 1.84%      | 2.25%      | 2.64%      | 2.41%      |

## 7.0 DEBT RESCHEDULING

7.1 Debt rescheduling opportunities have been very limited in the current economic climate given the consequent structure of interest rates. No debt rescheduling was undertaken during the first six months of 2018/19.

**Councillor Eamonn O'Brien**  
**Cabinet Member for Finance and Housing**

### List of Background Papers:-

None

### Contact Details:-

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