

CABINET

15 November 2016

Title: Treasury Management Strategy Statement Mid-Year Review 2016/17	
Report of the Cabinet Member for Finance, Growth and Investment	
Open Report	For Decision
Wards Affected: None	Key Decision: Yes
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Accountable Director: Kathy Freeman, Finance Director	
Accountable Strategic Director: Jonathan Bunt, Strategic Director of Finance and Investment	
Summary <p>Regulation changes have placed greater onus on elected Members in respect of the review and scrutiny of treasury management policy and activities. This mid-year review report is important in that respect as it provides details of the mid-year position for treasury activities and highlights compliance with the Council's policies previously approved by the Assembly.</p> <p>The Assembly agreed the Treasury Management Strategy Statement for 2016/17 on 24 February 2016 which incorporated the Prudential Indicators. This report updates Members on treasury management activities in the current year.</p>	
Recommendation(s) <p>The Cabinet is asked to recommend the Assembly to:</p> <ul style="list-style-type: none">(i) Note the Treasury Management Strategy Statement Mid-Year Review 2016/17;(ii) Note that the Council complied with all 2016/17 treasury management indicators during the first half of the 2016/17 financial year;(iii) Note that the value of investments as at 30 September 2016 totalled £259.0m;(iv) Note that the value of long-term borrowing as at 30 September 2016 totalled £454.9m, comprising market, PWLB and EIB loans; and(v) Note that the value of short term borrowing as at 30 September 2016 totalled £63.9m.	

Reason(s)

This report is required to be presented to the Assembly in accordance with the Revised CIPFA Code of Practice for Treasury Management in the Public Services.

1. Introduction and Background

- 1.1 The Council operates a balanced budget whereby cash raised during the year meets the Council's cash expenditure needs. Part of the treasury management operations is to ensure this cash flow is adequately planned, with surplus monies invested with counterparties of an appropriate level of risk, providing adequate liquidity before considering maximising investment return.
- 1.2 The second main function of treasury management is the funding of the Council's capital programme. These capital plans provide a guide to the Council's borrowing need, which is essentially the use of longer term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging loans, using cash flow surpluses or restructuring previously drawn debt to meet Council risk or cost objectives.
- 1.3 The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2011) recommends the:
- (i) Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management.
 - (ii) Creation and maintenance of Treasury Management Practices which set out the how the Council will seek to achieve those policies and objectives.
 - (iii) 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.
 - (iv) 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.
 - (v) Delegation by the Council to a specific named body, which for LBBDD is the Cabinet, to scrutinise the treasury management strategy and policies.
- 1.4 This mid-year report has been prepared in compliance with CIPFA's Code of practice on Treasury Management, and covers the following:
- 1. Economic Summary;
 - 2. Treasury Position at 30 September 2016;
 - 3. Debt Position as at 30 September 2016;
 - 4. Investment Portfolio 2016/17; and
 - 5. The Council's Capital Position (Prudential Indicators), including:
 - Prudential Indicator for Capital Expenditure
 - Changes to the Financing of the Capital Programme
 - Prudential Indicator – Capital Financing Requirement
 - Limits to Borrowing Activity.

2. Economic Update and Interest Rate Forecast

- 2.1 Throughout the first part of the financial year the economic data generally painted a picture of continued moderate growth with limited inflationary pressures. On 23 June 2016 the UK voted to leave the European Union, which shocked investment markets despite polls before the referendum suggesting that the vote could go either way.
- 2.2 The initial reactions in markets were pronounced: sterling fell dramatically, safe haven assets like government bonds rallied and equity markets were marked lower. Equity markets generally staged a recovery in the final days of the quarter, supported by expectations that interest rates would stay lower for longer.
- 2.3 The Bank of England (BOE) cut the Base Rate from 0.5% to 0.25% to try and reduce the impact of market volatility and due to the fact that the next political steps around Brexit lacked clarity. The BOE gave forward guidance that it expected to cut Base Rate again to near zero before the year end.
- 2.4 This cut directly reduced the interest rates on offer from financial institutions and from other Local Authorities. From an investment return point of view this will mean that the return target for the Council for 2017/18 and beyond will be more difficult to achieve. From a borrowing prospective the cost of borrowing is at a historical low and provides opportunities to fund capital spend where appropriate.
- 2.5 In the Eurozone, continued bond purchases by the ECB contributed to bond yields falling to record low levels. Meanwhile in the US, weak employment data released at the start of June saw the market re-price the likelihood of a Federal Reserve hike before the end of the year.
- 2.6 The Council's treasury advisor, Capita Asset Services (CAS) undertook a quarterly review of its interest rate forecasts after the Bank Rate cut. The forecast below includes a further cut to 0.10% in November 2016 and a first increase in May 2018, to 0.25%, but no further increase to 0.50% until a year later. The Monetary Policy Committee (MPC) is concerned about the impact of increases on heavily indebted consumers, especially if the growth in average disposable income is weak and could turn negative if inflation exceeds average pay increases over the next two years.

Table 1: Interest Rate and PWLB forecasts

	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19
Bank rate	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.25%	0.25%	0.25%	0.25%	0.50%
5yr PWLB rate	1.00%	1.00%	1.10%	1.10%	1.10%	1.10%	1.20%	1.20%	1.20%	1.20%	1.30%
10yr PWLB rate	1.50%	1.50%	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.70%	1.80%
25yr PWLB rate	2.30%	2.30%	2.40%	2.40%	2.40%	2.40%	2.50%	2.50%	2.50%	2.50%	2.60%
50yr PWLB rate	2.10%	2.10%	2.20%	2.20%	2.20%	2.20%	2.30%	2.30%	2.30%	2.30%	2.40%

3. Council Cash Position, Treasury Budget and Strategy Amendments

Council Cash Position

- 3.1 Table 2 details the Council's mid-year treasury position. Overall the Council's borrowing has increased from 31 March 2016 due to short-term borrowing positions and an additional £60m borrowed from the Public Works and Loan Board (PWLB). As a result, the average cost of borrowing has decreased. Investment balances remain elevated but the return has improved.

Table 2: Council's Treasury Position at 30 September 2016

	Principal Outstanding £000s	Rate of Return %	Average Life (yrs)
General Fund Fixed Rate Borrowing			
PWLB	60,000	2.52	46.2
Market Loans	119,000	2.66	32.9
Short Term Borrowing	63,948	0.32	0.2
Total General Fund Debt	242,948	2.01	27.6
Housing Revenue Account Fixed Rate Borrowing			
PWLB	265,912	3.50	39.3
Market Loans	10,000	3.98	61.7
Total Housing Revenue Account Debt	275,912	3.51	40.1
Total Council Borrowing	518,860	2.81	34.25
Investments			
Banks	188,218	1.33	0.91
Local Authorities	65,891	1.74	0.71
Other Investments	4,918	3.25	3.50
Total Investments	259,027	1.43	0.90

- 3.2 During the first half of the financial year the Council has used short term borrowing to cover a disconnect between financing of capital spend on schools and receiving the grant to fund this and to cover a prepayment to Elevate East London.

Treasury Budget Position

- 3.3 As part of the Council's savings proposals several revisions were made to the General Fund treasury budget for 2015/16 and 2016/17. The budget revisions resulted in **£4.6m** being removed from the Treasury budget. To achieve the interest income budget set, without taking significant risk, the treasury section has sought to increase the duration of a number of investments and make opportunistic investments as opportunities arise. Potential higher returns are weighed against the risk of locking in investments. In addition, at the July 2016 Assembly, Members approved the following changes in investment strategy:

- Increase the limit for Other UK Banks & Building Societies from £30m to £40m;
- Increase the Lloyds Banking Group limit from £50m to £65m; and
- Increase the limit for Property Investment from £15m to £20m.

- 3.4 Improved investment returns, higher than forecast cash balances, careful management of the Council's cash flow and its borrowing requirement has resulted in a forecast surplus of **£50k** in net interest against the revised budget for the General Fund. Table 3 summarises the 2016/17 budget, the forecast net interest and the variance between the 2016/17 budget and forecast.

Table 3: 2016/17 Treasury Interest Budget Position

Description	2016/17 Budget	2016/17 Forecast	Variance
	£000's	£000's	£000's
Interest Payable (excluding HRA)*	2,251	2,667	416
Net Interest to the General Fund*	(2,147)	(2,613)	(466)
Net Interest Payable to GF	104	54	(50)

* interest is for the General Fund and excludes HRA, Schools and EIB interest

European Investment Bank Loan

- 3.5 In August 2014, Cabinet agreed to the regeneration of the Gascoigne Estate Phase 1 and Abbey Road and that financing of £89m would be provided by a loan from the European Investment Bank (EIB). This decision was ratified by the Assembly in September 2014. Cabinet also agreed that, given the low borrowing costs at the time, £2m from the Budget Support Reserve (BSR) would be made available to pay for interest costs in the development period. On 30 January 2015 £89m was borrowed from the EIB at a competitive rate of 2.21% for a duration of 30 years.
- 3.6 Table 4 below provides a summary of the likely costs that will be charged to the BSR in 2016/17 and 2017/18 as a result of borrowing the full £89m in advance.

Table 4: 2016/17 EIB Borrowing Costs

	2016/17	2017/18
Gross Interest (EIB)	1,964,230	1,964,230
Interest Income from Abbey Road 2	(569,000)	(569,000)
Interest from Cash Balance	(595,000)	(300,000)
Total Charge	800,000	1,069,000
Remaining Reserve Available	1,080,000	11,000

- 3.7 In addition to the interest repayment, capital repayments of £2.3m needs to be paid for 2016/17 and 2017/18. This will be partially funded by income from Abbey 2 and Gascoigne Phase 1. Where there is a shortfall, short term borrowing will be used to fund this. It is expected that sufficient income will be received from Gascoigne Estate Phase 2 and Abbey Road to cover the interest and capital repayments to the EIB in 2018/19.

4. Debt Position at 30 September 2016

- 4.1 As part of the Ambition 2020 proposals, a strategy was agreed to increase the Council's income generating asset base and enable the Council to be an active participant in the growth opportunities within the borough but with a very clear focus on return. The target investment return expected, after all costs, is 5% based on £100m+ investment. The majority of the investment fund requires external

borrowing and a strategy of borrowing when costs are low was implemented in early 2016.

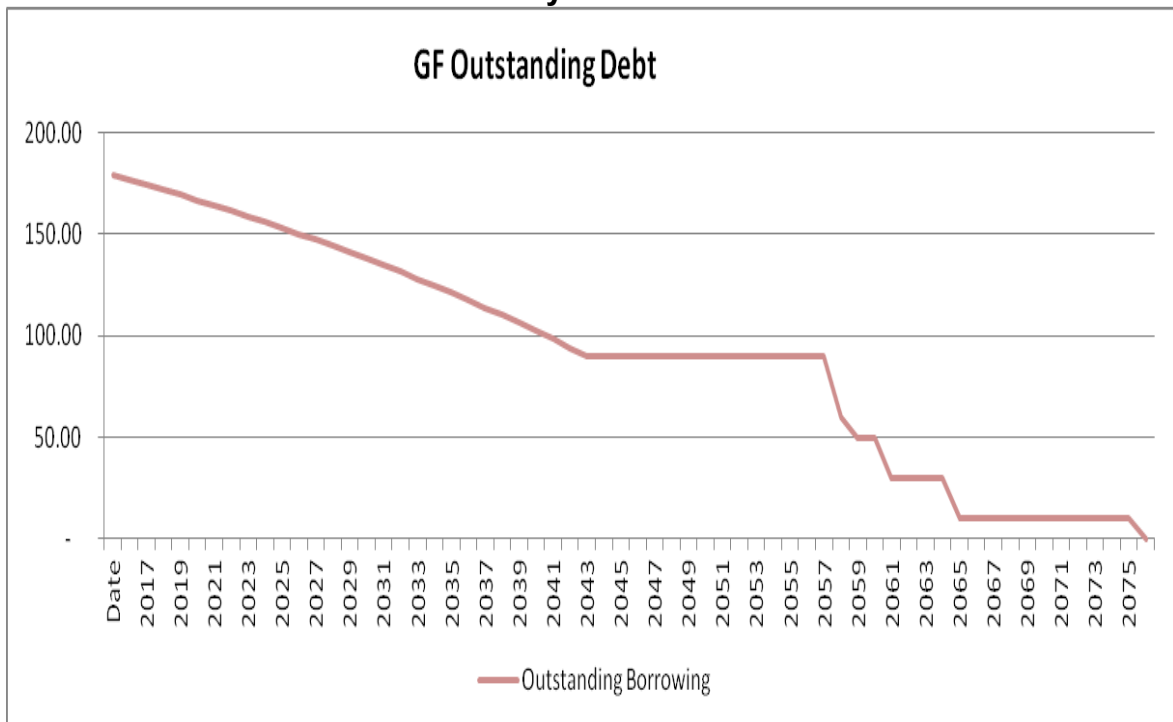
4.2 In June 2016, due to uncertainty over the referendum outcome, the cost of long term borrowing significantly reduced. As a result, the Strategic Director – Finance and Investments agreed to borrow £60m from the PWLB to fund the investment strategy. The actual borrowing is summarised below:

- On 09 June 2016, borrowed £20m at 2.72% with a 50 year maturity;
- On 14 June 2016, borrowed £10m at 2.65% with a 43.5 year maturity;
- On 28 June 2016, borrowed £10m at 2.49% with a 43.5 year maturity;
- On 29 June 2016, borrowed £10m at 2.38% with a 46 year maturity; and
- On 07 July 2016, borrowed £10m at 2.14% with a 46 year maturity.

4.3 The total General Fund borrowing, excluding short-term borrowing, is £179m at an average rate of 2.63%. The cost of the borrowing is included in the 2016/17 Treasury Interest Budget Position summarised in table 3. There is potential for further borrowing to be made should rates continue to remain low.

4.4 Although the size of the borrowing is significant, Members are asked to note that the EIB borrowing of £89m is an annuity repayment. This means that over the 30 years of the loan, a proportion will be repaid each year. The Council’s borrowing repayment is outlined in Chart 1 below and is based on the current General Fund borrowing position of £179m.

Chart 1: General Fund Debt Maturity



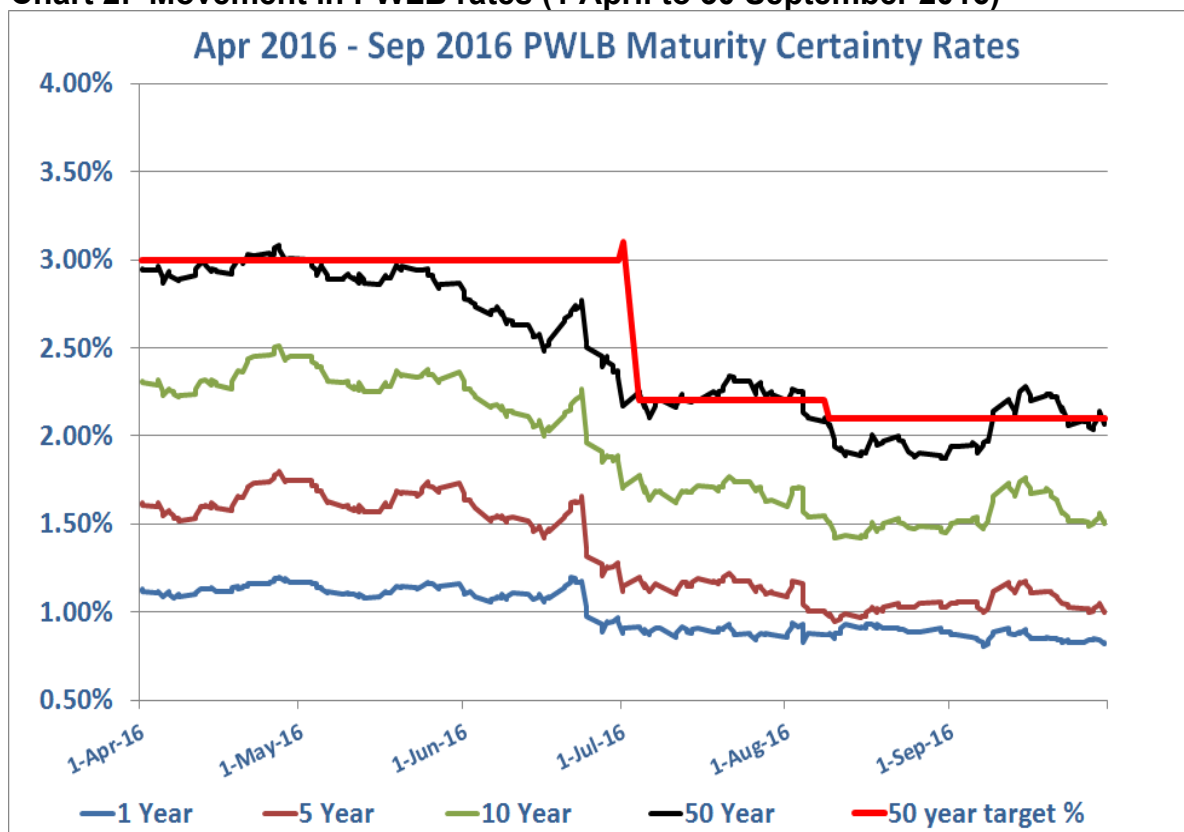
Debt Repayment and Rescheduling

- 4.5 Debt rescheduling opportunities are limited in the current economic climate. No debt rescheduling or repayments were undertaken during the first six months of the financial year.
- 4.6 In June 2016 Barclays sent a letter advising of a change to their Lender Option Borrower Option (LOBO) Loan with the Council. The loan was for £10m and the rate is 3.98% with a maturity of 2078. The change outlined by Barclays converted the loan to a fixed loan with a very long maturity and removed the Lender Option Borrower Option.
- 4.7 Given the long duration of the loan and the fixed rate, the SDFI, in consultation with the Cabinet Member for Finance agreed to transfer this debt across to the HRA. Having a very long dated loan at a competitive rate will reduce the HRA refinancing risk.

PWLB Rates

- 4.8 Chart 2 below shows the movements in PWLB rates for the first six months of the financial year (to 30 September 2016).

Chart 2: Movement in PWLB rates (1 April to 30 September 2016)



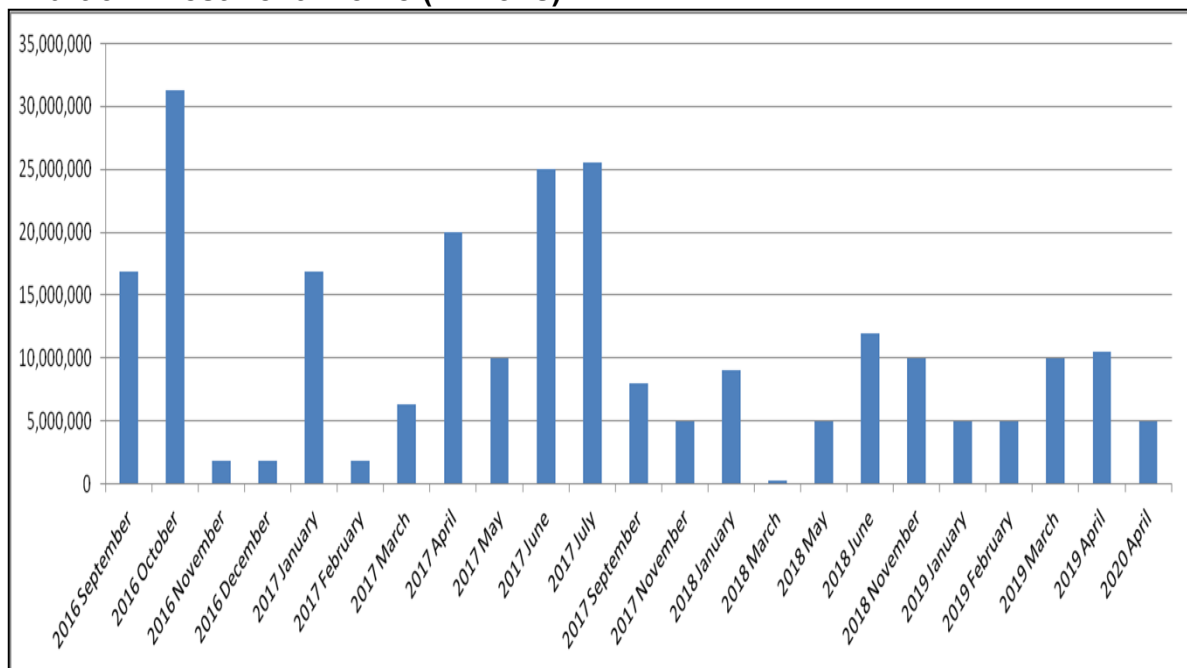
5. Investment Portfolio 2016/17

- 5.1 It is the Council's priority to ensure security of capital and liquidity before obtaining an appropriate level of return which is consistent with the Council's risk appetite. In the current economic climate, the Council's risk appetite remains relatively low, with the treasury section looking to take advantage of the fluctuations in rates offered by Local Authorities and Financial Institutions to lock in favourable rates without the need to take on significant additional risk.

Investment Profile

- 5.2 The Council's investment maturity profile in Chart 3 below shows that as at 30 September 2016, 7.7% of the Council's investments had a maturity of 60 days or less, with 61.3% having a maturity of one year or less. Spreading out the maturity of longer dated investments allows the Council to take advantage of improved rates of return while ensuring sufficient liquidity.

Chart 3: Investment Profile (Millions)



- 5.3 Although yields have remained at historically low levels for much of the first half of the financial year, several opportunistic investments have resulted in a much-improved average rate of return of **1.55%** for the first six months of the year.
- 5.4 The rate at 30 September 2016 is 1.43% indicating that the returns for the second part of the financial year will be lower than that achieved in the first half. It is also likely that the average rate for 2017/18 will struggle to achieve an average rate above 1.35%.

6. The Council's Capital Position (Prudential Indicators)

Prudential Indicator for Capital Expenditure

- 6.1 Table 6 shows the changes to the original capital expenditure budgets and highlights the original supported and unsupported elements of the capital programme, together with the expected financing arrangements of this capital expenditure.
- 6.2 The borrowing need increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced 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.

Table 5: Revised Estimate to Capital Programme as at 30 September 2016

Capital Expenditure by Service	2016/17 Original Budget £000s	2016/17 Revised Budget £000s
Service Development & Integration	58,625	61,722
Customer, Commercial & Service Delivery	7,812	9,046
Finance & Investment	4,297	3,029
Growth & Homes	56,669	61,257
HRA	74,000	62,659
Total	201,403	197,713
Financed by:		
Capital grants & contributions	70,391	79,065
Capital receipts	382	382
Contributions/Reserves	3,333	4,104
MRA/HRA funding	72,250	62,199
Total financing	146,356	145,750
Borrowing need	55,047	51,963

Prudential Indicator – CFR

- 6.3 Table 6 shows an increase in the CFR compared to original budget. The increase is predominantly due to costs related to expenditure within Growth and Homes. The SDFI reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.
- 6.4 The Authorised Limit 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. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.
- 6.5 There is currently a significant difference between the Authorised Limit and the actual borrowing. This difference is made up of internal borrowing, £61m which could potentially be borrowed from the European Investment Bank, and headroom to accommodate any potential new borrowing requirements.

Table 6: Revised Capital Financing Requirement as at 30 September 2016

	2016/17 Original Estimate £000s	2016/17 Revised Estimate £000s
Prudential Indicator – Capital Financing Requirement		
CFR – non housing	146,351	158,536
CFR – housing	267,722	278,472
Reside 1 and 2	117,932	155,186
Alternative Financing (PFI and leases)	55,047	51,713
Total CFR	587,052	643,907
Net movement in CFR	8,953	56,855
Prudential Indicator – External Debt / the Operational Boundary		
Long Term Borrowing	394,912	454,912
Other long term liabilities	55,047	51,713
Total debt 31 March	449,959	506,625
Operational Boundary	745,000	745,000
Authorised Limit	803,000	803,000

Treasury Indicators: Limits to Borrowing Activity

6.6 There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance. The indicators are:

- Upper limits on variable interest rate exposure: identifies a maximum limit for variable interest rates based upon the debt position net of investments;
- Upper limits on fixed interest rate exposure: is similar to the previous indicator and covers a maximum limit on fixed interest rates; and
- Maturity structure of borrowing: gross limits to reduce the Council's exposure to large fixed rate sums requiring refinancing.

6.7 The SDFI reports that there were no breaches in any of the limits outlined below:

Interest rate exposures	2015/16	2016/17	2017/18
	Upper	Upper	Upper
Limits on fixed interest rates based on net debt	100%	100%	100%
Limits on variable interest rates based on net debt	70%	70%	70%
Limits on fixed interest rates:			
• Debt only	100%	100%	100%
• Investments only	80%	80%	80%
Limits on variable interest rates			
• Debt only	70%	70%	70%
• Investments only	80%	80%	80%

Maturity structure of fixed interest rate borrowing 2015/16		
	Lower	Upper
Under 12 months	0%	40%
12 months to 2 years	0%	40%
2 years to 5 years	0%	70%
5 years to 10 years	0%	70%
10 years and above	0%	100%

Maturity structure of variable interest rate borrowing 2015/16		
	Lower	Upper
Under 12 months	0%	40%
12 months to 2 years	0%	40%
2 years to 5 years	0%	70%
5 years to 10 years	0%	70%
10 years and above	0%	80%

7. Consultation

- 7.1 The Strategic Director, Finance & Investment, in his role as statutory chief finance officer, has been informed of the approach, data and commentary in this report.

8. Financial Implications

Implications completed by: Kathy Freeman, Finance Director

- 8.1 This report sets out the mid-year position on the Council's treasury management position and is concerned with the returns on the Council's investments as well as its short and long term borrowing positions.

9. Legal Implications

Implications completed by: Dr. Paul Feild, Senior Governance Lawyer

- 9.1 Section 28 of the Local Government Act 2003 imposes a statutory duty on the Council to monitor during the financial year its expenditure and income against the budget calculations. The Council sets out its treasury strategy for borrowing and an Annual Investment Strategy which sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.
- 9.2 The Council also should 'have regard to' the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities when carrying out its functions under the Act.
- 9.3 A report setting out the Council's strategies in accordance with the Act was presented to Cabinet and Assembly in February 2016. This report is a mid-year review of the strategy's application and there are no further legal implications to highlight.

10. Options Appraisal

- 10.1 There is no legal requirement to prepare a Treasury Management Strategy Statement Mid-Year Review; however, it is good governance to do so and meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

11. Other Implications

- 11.1 **Risk Management** - The whole report concerns itself with the management of risks relating to the Council's cash flow. The report mostly contains information on how the Treasury Management Strategy has been used to maximise income during the first 6 months of the year.

Public Background Papers Used in the Preparation of the Report:

- HRA Business Plan (<http://moderngov.barking-dagenham.gov.uk/ieListDocuments.aspx?CId=180&MId=8150&Ver=4>)
- Treasury Management Strategy Statement - Assembly Report 24 February 2016 (<http://moderngov.barking-dagenham.gov.uk/ieListDocuments.aspx?CId=179&MId=8618&Ver=4>)

List of appendices:

- Appendix 1: Investments as at 30 September 2016