

CABINET

14 November 2017

Title: Treasury Management 2017/18 Mid-Year Review	
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: Claire Symonds, Chief Operating Officer	
Summary 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 provides details of the mid-year position for treasury activities and highlights compliance with the Council's policies previously approved by the Assembly. The Assembly agreed the Treasury Management Strategy Statement for 2017/18 on 22 February 2017, which incorporated the Prudential Indicators. This report updates Members on treasury management activities in the current year.	
Recommendation(s) The Cabinet is recommended to: (i) Approve a loan of up to £595,000 for Barking & Dagenham Trading Partnership, as detailed in paragraph 6.5 of the report; and (ii) Delegate authority to the Chief Operating Officer, in consultation with the Cabinet Member for Finance, Growth and Investment, to agree contractual terms, including the rate, duration and security as part of the loan agreements; The Cabinet is asked to recommend the Assembly to: (iii) Note the Treasury Management Strategy Statement Mid-Year Review 2017/18; (iv) Note that in the first half of the 2017/18 financial year the Council complied with all 2017/18 treasury management indicators; (v) Note the value of investments at 30 September 2017 totalled £250.5 million;	

- (vi) Note the value of long term borrowing at 30 September 2017 totalled £502.2m, comprising market, PWLB and EIB loans;
- (vii) Note the value of short term borrowing at 30 September 2017 totalled £70.0m; and
- (viii) Agree the revised Minimum Revenue Provision Policy Statement in Appendix 1;

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 A third main function of treasury management is the funding and treasury advice that is required for the Council's Investment and Acquisitions Strategy.
- 1.4 The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2011) following practices are adopted in that a public authority should the:
 - I. Maintain a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management.
 - II. Maintain a Treasury Management Practices which set out the how the Council will seek to achieve those policies and objectives.
 - III. Receipt by full Council of a Treasury Management Strategy Statement, (TMSS) including the Annual Investment Strategy (AIS) and Minimum Revenue Provision (MRP) Policy for the year ahead; a Mid-Year Review Report; and an Annual 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, for this Council this is Cabinet, to scrutinise the treasury management strategy and policies.
- 1.5 This mid-year report has been prepared in compliance with CIPFA's Code of practice on Treasury Management, and covers the following:
 - 1. Economic Update and Interest Rate Forecast;
 - 2. Cash Position as at 30 September 2017;
 - 3. Interest Budget Position as at 30 September 2017;
 - 4. Council's Investment and Acquisitions Strategy;

5. Treasury Position at 30 September 2017;
6. Debt Position as at 30 September 2017;
7. Investment Portfolio 2017/18;
8. Minimum Revenue Provision Review; and
9. The Council's Capital Position (Prudential Indicators).

2. Economic Update and Interest Rate Forecast

- 2.1 The first half of the financial year saw volatility within yields, due to uncertainty over Brexit. From July to early September yields dropped significantly due to poor economic data and a decrease in inflation, which supported the view that the Bank of England would not raise its base rate in the near future. Yields reached a low point for the year on 8 September.
- 2.2 However, September saw two major developments: -
 1. The Monetary Policy Committee (MPC) minutes indicated a majority of MPC members would likely vote for some monetary stimulus withdrawal if the economy performed consistently with its central projections i.e. there does not need to be a pickup in growth for Bank Rate to rise.
 2. MPC member, Gertjan Vleighe, who previously voted no to rate increases, made a speech where he indicated he was likely to vote for a rate increase.
- 2.3 These events caused a sharp jump in market expectations of an increase in Bank Rate in November 2017 and there were sharp increases in market rates, gilt yields, and PWLB rates. Chart 1 below shows the 25-year gilt rate movements to 30 September 2017, illustrating the volatility in the rates.

Chart 1: 25-year gilt rate



- 2.4 Despite the increase in gilt yields in September, it is important to note that economic data is not indicating a strong pickup in growth and there is no change in expectation that inflation will fall back towards the 2% target over the next two years as the devaluation of sterling after the referendum works its way out of the economy and drops out of the statistics. This sharp change in sentiment from the MPC is therefore word driven, rather than data driven. It reveals a shift in MPC opinion towards the withdrawal of the 0.25% cut in Bank Rate in August 2016.

2.5 With regards to the Council's treasury strategy, it is now more likely that the MPC will raise the Bank Rate by 0.25% in November. The question then remains as to whether or not they will stop at this point for a lengthy pause, or will launch into a series of further rate increases in 2018.

3. Council's Cash Position as at 30 September 2017

3.1 Council Cash Position

Table 1 details the Council's mid-year treasury position. Overall the Council's borrowing has increased from 31 March 2017 due to an increase in borrowing from other Local Authorities and an additional £40m borrowed from the PWLB. Investment balances remain elevated, but the return has remained around 1.36%.

Table 1: Council's Treasury Position at 30 September 2017

	Principal Outstanding £000s	Rate of Return %	Average Life (yrs)
General Fund Fixed Rate Borrowing			
PWLB	100,000	2.38	41.6
Market Loans	117,363	2.68	32.0
Medium Term Borrowing	19,000	0.97	2.4
Short Term Borrowing	69,950	0.29	0.3
Total General Fund Debt	306,313	1.93	26.1
Housing Revenue Account Fixed Rate Borrowing			
PWLB	265,912	3.50	38.3
Market Loans	10,000	3.98	60.7
Total Housing Revenue Account Debt	275,912	3.51	40.1
Total Council Borrowing	572,225	2.66	31.8
Investments	250,592	1.36	0.91

3.2 Overall the Council has a significant level of cash available to fund its Street and Land Purchase scheme. Cash levels will be monitored, and additional borrowing taken as and when required for the Councils Investment and Acquisitions Strategy.

4. Interest Budget Position as at 30 September 2017

4.1 As part of the Council's savings proposals a saving of **£4.6m** was allocated to the treasury budget in 2015/16. Subsequently **£1.9m** has been added to the interest payable budget for 2017/18 to fund the Council's Street and Land Purchase scheme. Improved investment returns and careful management of the Council's cash flow and borrowing requirement has resulted in a forecast surplus of **£23k** in net interest against the 2017/18 budget for the General Fund. Table 2 summarises the 2017/18 budget, the forecast net interest and the variance.

Table 2: 2017/18 Treasury Interest Budget Position

Description	2017/18 Budget	2017/18 Forecast	Variance
	£000's	£000's	£000's
Interest Payable (Excluding HRA) *	4,233	5,858	1,625
Net Interest to the General Fund*	(2,147)	(3,795)	(1,648)
Net Interest Payable to GF	2,086	2,063	(23)

* interest is for the General Fund and excludes HRA borrowing costs

5. Council's Investment and Acquisitions Strategy

- 5.1 Historically the Council has either been debt free or has had a very low-level of debt. This changed significantly in 2012 when, as part of the HRA reform, £265.9m of debt was transferred to the Council' HRA. In January 2015, £89m was borrowed for the Council's General Fund from the European Investment Bank to fund the regeneration of Abbey Road and Gascoigne Phase 1. Abbey Road is currently operational, and Gascoigne Phase 1 will be operational in 2018.
- 5.2 In November 2016, Cabinet approved the establishment of an Investment and Acquisition Strategy (IAS). Cabinet also approved an initial £250m investment budget and £100m land and property acquisition budget to support delivery of the IAS. The purpose of the IAS is to support the Borough's growth opportunities and to ensure that the Council, and future generations, benefit by increasing the Council's ownership of long-term income producing assets.
- 5.3 The IAS has an income objective and a target of delivering £5.12m by 2020/21. The investment programme will be delivered primarily by the Council's new development vehicle, Be First, and it is expected that Be First will accelerate the regeneration of the borough.
- 5.4 The IAS will support the Council to fundamentally change its approach to investment and regeneration. Going forward the Council will need to become a proactive developer and investor, helping to support growth opportunities and ensure that the Council and future generations benefit by increasing its ownership of long-term income producing assets. Potentially 44 schemes are in the pipeline over a period of 15 years.
- 5.5 The total capital expenditure is estimated at over £2.0bn over the next twenty years, were the whole programme to be funded by the Council. Whilst the Council will use, where possible, any capital receipts it may generate from land sales to help finance acquisition costs, the main source of financing of the full programme would need to be from borrowing.
- 5.6 It is expected that the net capital expenditure required, which is the capital spend less any money received from private sales and Shared Ownership, will be significantly less than £2.0bn. There may also be occasions where refinancing may be used to secure borrowing on the properties when they are operational and in some cases properties will be sold to fund new regeneration schemes.

5.7 Due to the scale of the planned regeneration programme the PWLB will still be considered, especially when rates are low, but in addition, institutional funders, the Municipal Bonds Agency or from the European Investment Bank will also be considered. In addition, it may be more advantageous to consider raising further finance through the issuance of a bond. A range of borrowing periods will also be used based on cashflow requirement, ensuring that not all borrowing is long term and that the debt repayment is linked to the income generated from both the rental returns and the sales receipts. The Chief Operating Officer (COO), advised by the Investment Panel and external advisors, will consider the optimum funding mix for each investment to meet the investment return objectives.

6. Debt Position at 30 September 2017

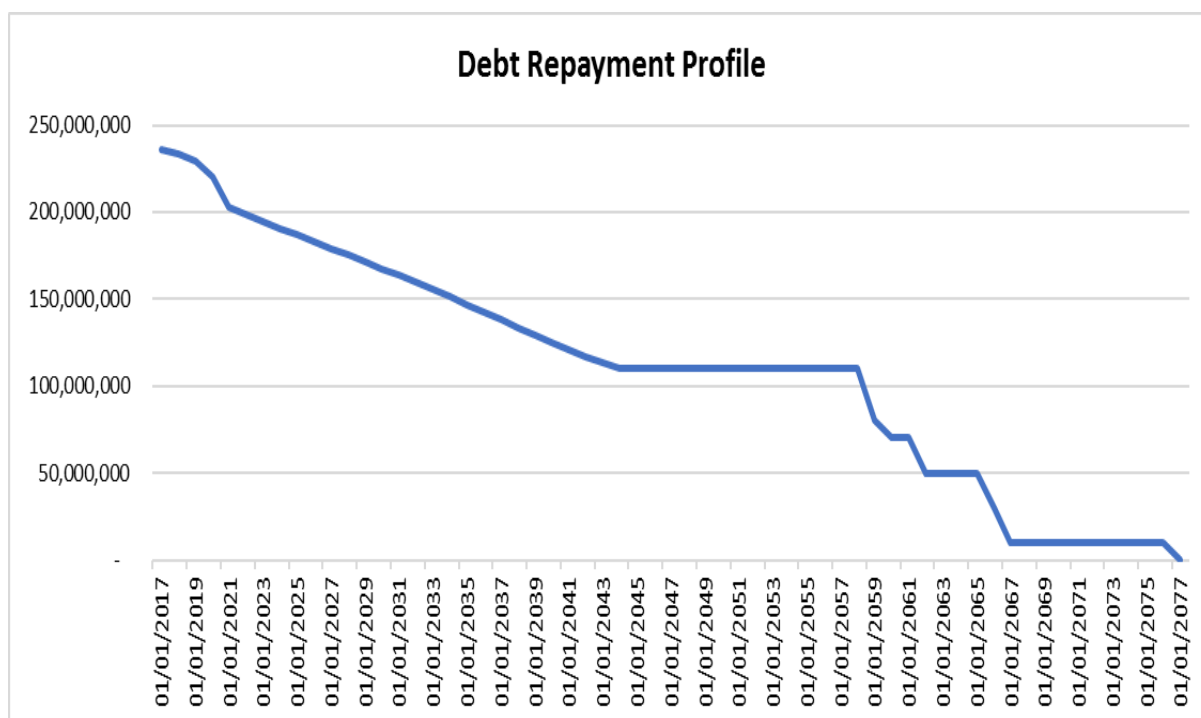
6.1 During 2016/17 the treasury section borrowed £60.0m from the PWLB to fund the IAS at a rate of 2.52% and for an average duration of 46.5 years.

6.2 For the first half of the Financial year, the treasury section has borrowed a further £40.0m of long term debt from the PWLB and £19.0m of debt with a maturity of 3 years from other Local Authorities. The average rate borrowed at was 1.78%. Details of the loans are below:

Repayment Type	Counterparty	Start Date	End Date	Amount £000s	Rate %
Repay on Maturity	Wycombe DC	03/04/2017	09/12/2019	5,000	0.90
Repay on Maturity	Cornwall CC	03/04/2017	03/04/2020	10,000	1.00
Repay on Maturity	Stevenage BC	09/01/2017	09/04/2020	2,000	0.98
Repay on Maturity	Rugby BC	09/01/2017	09/04/2020	2,000	1.00
Repay on Maturity	PWLB	05/04/2017	05/04/2067	20,000	2.36
EIP	PWLB	12/09/2017	12/09/2040	20,000	1.98
		Total Borrowed:		59,000	

6.3 Although the size of the Council's overall borrowing is significant, Members are asked to note that the EIB borrowing of £87m is an annuity repayment. This means that over the 30 years of the loan, a proportion will be repaid each year. In addition, the £20m borrowed in September 2017 has an equal instalment payment (EIP) type, which means that an equal portion of the debt will be repaid each year until its maturity. The Council's borrowing repayment is outlined in Chart 2 below and is based on the current General Fund borrowing position of £236.4m.

Chart 2: General Fund Debt Maturity



Transformation Update

- 6.4 **Be First** - The Be First business plan is expected to be reported at the February 2018 Cabinet and will outline the borrowing requirement to fund the Investment and Acquisitions programme. The level of borrowing, the structure and debt repayment profiles will be outlined in the Treasury Management Strategy Statement (TMSS) that will also be presented to Cabinet for Council approval in February 2018.
- 6.5 **Traded Services** - In the February 2017 TMSS, Members agreed a £150,000 loan as part of the initial set-up costs for Traded Services. A business plan has been completed for what is now called 'Barking & Dagenham Trading Partnership' and Members are now asked to agree seed capital and a loan of £595,000 to cover initial set-up costs, including training, branding, marketing, communications, specialist resources required to set up the new company and initial governance costs such as payments to Directors.

Debt Repayment and Rescheduling

- 6.6 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.

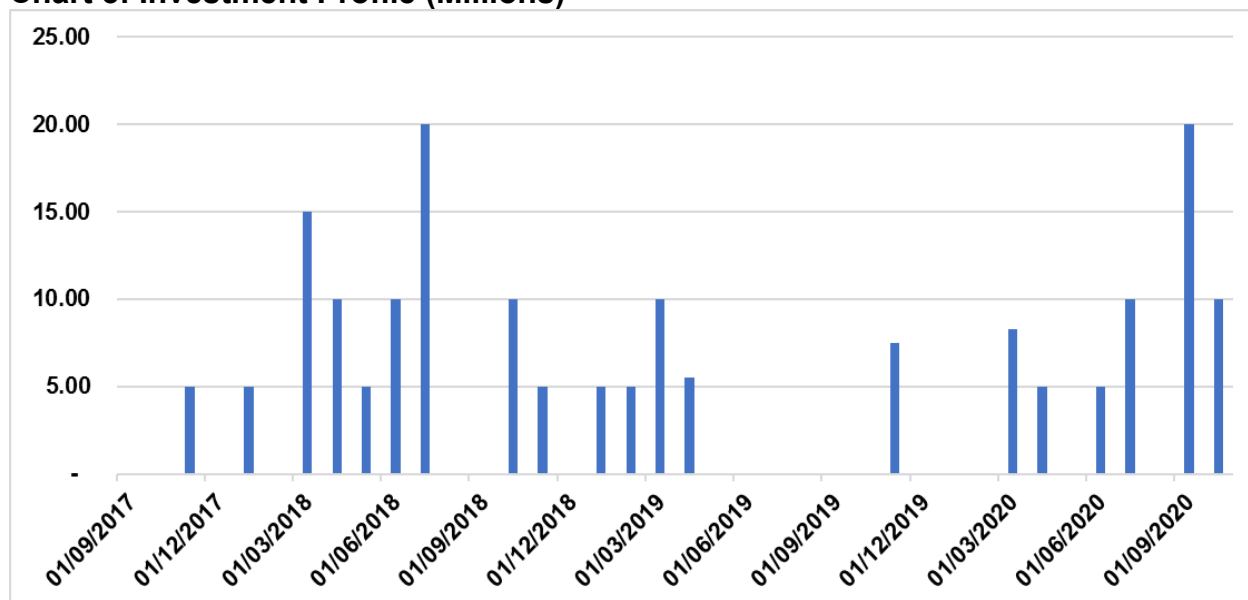
7. Investment Portfolio 2017/18

- 7.1 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.

7.2 As at 30 September 2017 the Council held £250.6m in cash, with £92m invested with Local Authorities, £150.5m held in deposits with banks and £8m held in a Money Market Fund.

7.3 The Council's investment maturity profile in Chart 3 below shows that as at 30 September 2017, 2.0% of the Council's investments had a maturity of 60 days or less, with 36.4% 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)



7.4 Although yields have remained at historically low levels for much of the first half of the financial year, a number of opportunistic investments have resulted in a much-improved average rate of return of **1.38%** for the first six months of the year. The rate at 30 September 2017 is **1.36%** indicating that the returns for the second part of the financial year will be similar to those achieved in the first half. It is also likely that the average rate for 2018/19 will average approximately **1.37%**.

7.5 Due to the Council's increased investment and capital programme, investments will continue to be made to reduce the cost of carry of any borrowing. In addition investment will be made to match the cashflow requirements to ensure that, where significant expenditure is required, sufficient cash is available to cover this, thereby reducing the need to take out long term borrowing when rates may be elevated.

8. Minimum Revenue Provision (MRP) Review

8.1 Regulations 27 and 28 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (as amended) require that a local authority "shall determine for the current financial year an amount of minimum revenue provision which it considers to be prudent". MRP is a charge to the revenue account in relation to capital expenditure financed from borrowing or credit arrangements, often referred as a provision for the repayment of debt.

- 8.2 Prior to 2007 the arrangements for determining debt repayment were prescriptive. In 2007, this was replaced by a system of self-regulation that aligns with the prudential code and accounting codes to allow authorities local discretion based on their own judgement as to what is prudent. The Secretary of State has issued statutory Guidance on determining the “prudent” level of MRP.
- 8.3 It is timely that the Council reviews its MRP policy to ensure it remains prudent and provides a stable and deliverable financial position whilst ensuring the prudent management of the Council’s finances generally. There is freedom for authorities to consider annual profiling of MRP which fits the prudent management of its own financial circumstances, providing that it meets the basic test of “prudence” which is to repay debt over the life of the benefit or the period implied by the associated grant.
- 8.4 Appendix 1 of this report seeks to make several amendments to the Council’s MRP policy, predominantly covering MRP for property held in Special Purpose Vehicles:
- i. Where capital expenditure involves repayable loans or grants to third parties no MRP is required where the loan or grant is repayable.
 - ii. Where capital expenditure involves a variety of works and assets, the period over which the overall expenditure is judged to have benefit over shall be considered as the asset life for MRP purposes. Expenditure arising from or related or incidental to major elements of a capital project may be treated as having the same asset life for MRP purposes as the major element itself. An estimate of the life of capital expenditure may also be made by reference to a collection or grouping of expenditure type or types.
 - iii. The Council intends to use SPVs held through Reside to manage its property regeneration schemes. This will require the Council borrowing to provide funding for the SPV. The annuity repayments from the SPV to the Council over the useful life of the asset will be treated as the MRP for the project in question.
 - iv. Where an investment property is operational and has been valued at sufficiently more than its net cost, as at each financial year end, at the discretion of the COO, no MRP will need to be set aside during that year. A key consideration of the COO will be if the property can be sold in an open market and that sale will potentially take place within a five-year period. Any MRP already set aside for the investment property will be retained as a reserve against the property. For subsequent years a revaluation of the property will need to be completed. Where the asset is valued at less than its net cost, then MRP, net of any MRP already charged and based on the remaining life of the asset, will need to be set aside.
 - v. The Council has invested in a number of Private Sector housing schemes. A recent increase in valuation in an existing scheme reported an increase in equity of the particular development. A change has been made to the Council’s Minimum Revenue Provision policy to not set aside debt repayment for the scheme. The development will be held for investment purposes and subject to an annual market valuation. In the event of a market downturn, funding has been set aside in an earmarked reserve for the debt repayment.

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

9.1 Prudential Indicator for Capital Expenditure

Table 3 shows the changes to the original capital expenditure budgets. Table 3 also highlights the original supported and unsupported elements of the capital programme, and the expected financing arrangements of this capital expenditure.

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.

The increase in revised budget when compared to the original budget revised, as outlined in table 3 below, is mainly due to the addition to the capital programme of the Street Purchases and Land Acquisition Programmes.

Table 3: Revised Estimate to Capital Programme as at 30 September 2017

Capital Expenditure by Service	2017/18 Original Budget £000s	2017/18 Revised Budget £000s
Be First	1,980	1,980
Care & Support	1,790	1,870
Community Solutions	4,330	4,280
Core	8,300	8,300
Customer Access Technology	4,360	4,360
Education, Youth and Childcare	25,070	25,320
Enforcement	10,170	9,380
Culture, Heritage and Recreation	4,300	1,060
Investment Strategy	480	10,480
Regeneration	67,660	90,380
My Place	1,210	1,210
Public Realm	1,080	1,080
SDI Commissioning	4,460	4,460
Traded Services	520	520
HRA	90,720	68,660
TOTAL	226,430	233,340
Capital Grants and Contributions	38,415	42,553
Revenue / Reserve Contributions	990	590
HRA Contributions (incl MRA)	80,895	57,938
Capital Receipts	23,584	19,359
Sub-Total	143,884	120,440
Net financing need for the year (borrowing)	82,546	112,900

9.2 Prudential Indicator – CFR

Table 4 shows that the Council’s revised CFR will not exceed the Operational boundary. The COO reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

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. 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.

Table 4: Revised Capital Financing Requirement as at 30 September 2017

	2017/18 Original Estimate £000s	2017/18 Revised Estimate £000s
Prudential Indicator – Capital Financing Requirement		
CFR – non-housing	165,754	165,754
CFR – housing	276,231	276,231
Reside 1 and 2	117,342	117,342
PFI and Leases	48,886	48,886
Alternative Financing	82,546	112,900
Total CFR	690,759	721,114
Net movement in CFR	70,571	100,925
Prudential Indicator – External Debt / the Operational Boundary		
Long Term Borrowing	492,275	552,275
Other long-term liabilities	52,308	52,308
Total debt 31 March	544,583	604,583
Operational Boundary	752,000	752,000
Authorised Limit	902,000	902,000

incl. rounding differences

9.3 Treasury Indicators: Limits to Borrowing Activity

There are three PI’s for 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:

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

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

Interest rate exposures	2017/18	2018/19	2019/20
	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	90%	90%	90%
Limits on variable interest rates			
• Debt only	70%	70%	70%
• Investments only	80%	80%	80%

Maturity structure of fixed interest rate borrowing 2017/18		
	Lower	Upper
Under 12 months	0%	40%
12 months to 2 years	0%	60%
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 2017/18		
	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%

10. Consultation

- 10.1 The Chief Operating Officer, in her role as statutory chief finance officer, has been informed of the approach, data and commentary in this report.

11. Financial Implications

Implications completed by: Kathy Freeman, Finance Director

- 11.1 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.

12. Legal Implications

Implications completed by: Dr Paul Feild, Senior Corporate Governance Solicitor

- 12.1 The Local Government Act 2003 (the “Act”) requires the Council to establish a treasury strategy for borrowing and to prepare 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.
- 12.2 The Council also has to ‘have regard to’ the CIPFA Code of Practice on Treasury Management (2011) and the CIPFA Prudential Code for Capital Finance in Local Authorities when carrying out its functions under the Act.
- 12.3 A report setting out the Council’s strategies in accordance with the Act was presented to Cabinet in February 2017. This report is a midyear review of the strategy’s application and there are no further legal implications to highlight.

13. Options Appraisal

- 13.1 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).

14. Other Implications

- 14.1 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: None

List of appendices:

- Appendix 1: Minimum Revenue Provision Review
- Appendix 2: Investments as at 30 September 2017