Policy and Scrutiny

Open Report on behalf of Executive Director of Finance & Public Protection

Report to:	**Overview and Scrutiny Management Board**
Date:	**01 March 2018**
Subject:	**Treasury Management Update 2017/18 -Quarter 3 Update Report to 30 December 2017**

Summary:

This report has been prepared in accordance with the reporting recommendations of the CIPFA Code of Practice 2011 and details the results of the Council's treasury management activities for 2017/18 to 31 December 2017, comparing this activity to the Treasury Management Strategy for 2017/18, approved by the Executive Councillor for Finance on 20th March 2017. It will also detail any issues arising in treasury management during this period.

Actions Required:

That the report be noted and any comments to be passed onto the Executive Councillor with responsibilities for Finance.

1. Background

1. Introduction and Background

1.1. Treasury Management relates to the policies, strategies and processes associated with managing the cash and debt of the Council through appropriate borrowing and lending activity. It includes the effective control of the risks associated with the lending and borrowing activity and the pursuit of optimum performance consistent with the risks.

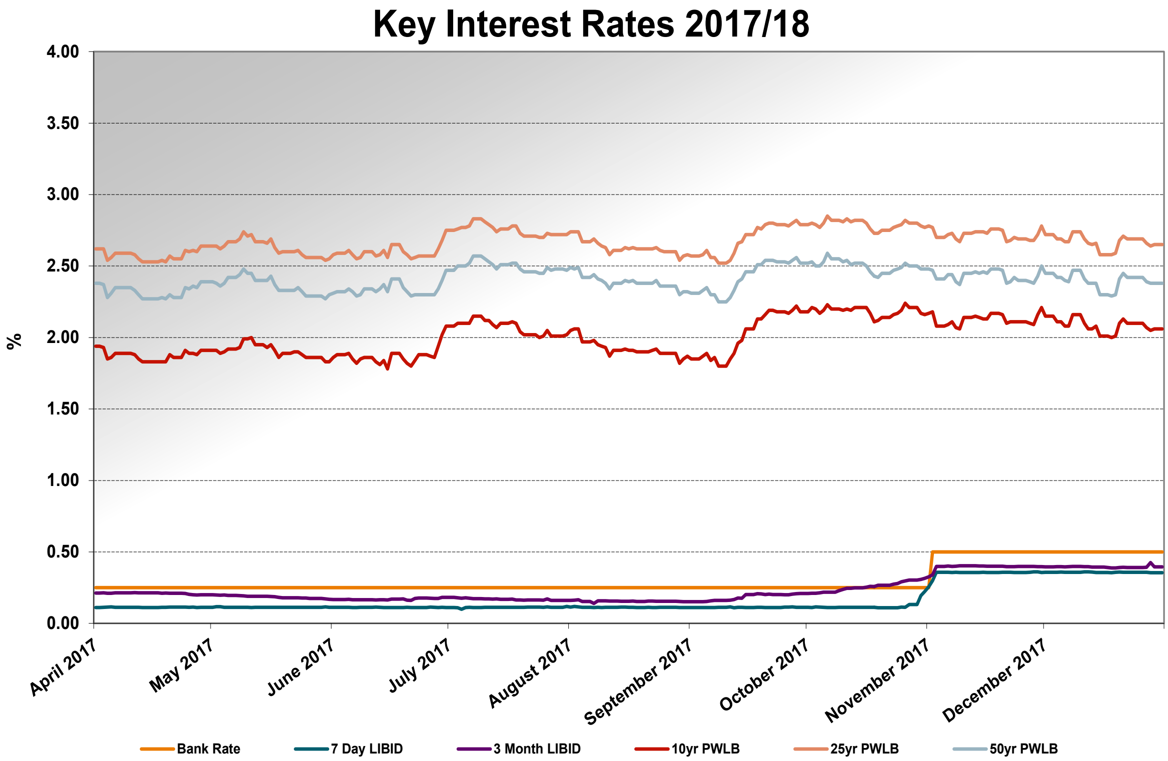
1.2. This Treasury Report will cover the following positions to 31st December 2017:

- Interest rate review, economic overview and revised interest rate forecast.
- Annual investment strategy/ authorised lending list changes during the quarter.
- Investment position and comparison with strategy.
- Borrowing & debt rescheduling position and comparison with strategy.
- Other Treasury Management issues arising during period.

2. Interest Rate Review, Economic Overview and Revised Interest Rate Forecast to 31st December 2017

2.1. At the time of setting the Strategy in March 2017, short term bank rate was expected to remain at 0.25% for the year and long term rates were forecast to rise no more than 0.10% by the end of the year.

2.2. The graph below shows that short term rates have risen gradually since the Base Rate was increased for the first time in a decade on 2nd November 2017 to 0.50%. Long term rates have ended December 2017 at similar levels at which they started the year with fluctuations in between.



2.3. Economic Background -The quarter ended 31st December 2017 saw the following:

- The economy maintained a mediocre pace. Forecasts for growth in 2017 are now around 1.7% -1.8%, not far off the 2016 revised level.
- Headline inflation reached its highest level since March 2012 at 3.1% in November 2017. However signs are showing that this will be the peak and that the rate will start to fall.
- Employment fell, but there were some signs of a pick-up in wage growth, although this is still being outpaced by inflation. Unemployment remained steady at 4.3%.

- The MPC took a more hawkish turn and increased Bank Rate on 2nd November 2017 to 0.50%, hinting however that there would only be a further two increases by 2020.
- The Chancellor provided a bigger-than-expected Budget giveaway.
- The European Commission gave the green light to progress to the second phase of Brexit negotiations.

2.4. The latest interest rate forecast from Link dated 7th November 2017 has not changed since the Quarter 2 update report. The forecast reflected the Base Rate change in November and the BOE November Inflation Report.

Link Asset Services Interest Rate View													
	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%
5yr PWLB rate	1.60%	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%
10yr PWLB rate	2.20%	2.30%	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%
25yr PWLB rate	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB rate	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%

The BOE increased Base Rate at a time when economic growth in 2017 had been disappointingly weak, but gave forward guidance that they expected to increase Base Rate only twice more in the next three years to reach 1.0% by 2020. Due to the uncertainty of Brexit, Link view the overall balance of risks to economic recovery in the UK to be on the downside; however, given those uncertainties, see a wide diversity of possible outcomes for the strength of economic growth and inflation, and the corresponding speed with which Bank Rate could go up.

3. <u>Annual Investment Strategy/ Authorised Lending List Changes to 31st December 2017</u>

3.1. The Council's Annual Investment Strategy for 2017/18 was approved, along with the Treasury Strategy, by the Executive Councillor for Finance on 20th March 2017, after being scrutinised by the Value For Money Scrutiny Committee on 28th February 2017. The Strategy outlines the Council's investment priorities as **the security of capital and the liquidity of investments**, with the aim to achieve the optimum return on investments commensurate with proper levels of security and liquidity.

3.2. As such investments are only placed with highly credit rated financial institutions, using Link's suggested creditworthiness approach, including Short and Long Term Ratings, Sovereign Credit Ratings and Credit Default Swap overlay information provided by Link.

3.3. In addition to Link's credit methodology, the Council also maintains a minimum limit of **A+ Long Term Rating (two out of three agencies)** for all its Counterparties, excluding part-nationalised UK banks and a **minimum limit AA- Sovereign Rating, (two out of three agencies)** for any Country in which a Counterparty is based. Appendix A shows the Council's Authorised Lending List at 31st December 2017, based on this creditworthiness approach, together with a key explaining the credit rating scores.

3.4. There were no changes to the Authorised Lending List during the third quarter of 2017/18. There were also no breaches of Lending Limit over the quarter to 31st December 2017 due to limit changes or error.

3.5. A full list of the investments held at 31st December 2017, compared to Link's creditworthiness list, and changes to credit rating of counterparties during December 2017 are shown in Appendix B.

4. Investment Position to 31st December 2017- Comparison with Strategy

4.1. The Council's investment position and cumulative annualised return at 31st December 2017 are detailed in the table below:

Investment Position At 30.12.17	Return (Annualised %)	Weighted Benchmark (Annualised %)	Outperformance
£306.280m	**0.52%**	**0.22%**	**0.30%**

4.2. The investment balance is made up of general and earmarked reserves, Pension Fund cash, borrowing and other income received but not yet used/spent and general movement in debtor and creditor amounts.

4.3. All investments have been placed in line with the Strategy, mainly in Money Market Funds. Several one year investments were made during the period. The investment portfolio weighted average maturity (WAM) has fallen slightly from 172 days at 30th September 2017 to 145 days at 31st December 2017.

4.4. The benchmark target return used is a weighted benchmark that uses both the 7 day LIBID and 3 month LIBID market rates, weighted, to better reflect the maturity of the investments made and therefore the risk parameters of the investment portfolio. Being a market rate, this benchmark moves relative to market movements and is therefore the target rate used for investments.

4.5. The investment performance was also benchmarked against the Link quarterly benchmark analysis, comprising a mixture of 9 other authorities in the East Midlands area and 16 English Counties. The results of this benchmarking for the 3rd quarter are detailed below, which shows that the Council's return was above that of the comparators, achieved by having a longer WAM. The Council's return is also in line with Link's suggested risk banding achievable for the level of risk being taken on its investments.

Link Benchmarking –Position at 31/12/2017			
	LCC	Benchmark Group (9)	English Counties (12)
31 Dec Return %	0.54%	0.48%	0.53%
Risk Banding	0.51% to 0.61%	0.41% to 0.51%	0.46% to 0.56%
WAM (days)	145	77	93

4.6. Temporary borrowing of £31m was outstanding at 31st December 2017, taken to support identified cashflow shortfalls forecast in 2017/18. This was at an average interest rate of 0.30% and is cash neutral being offset with Investment returns in excess of this amount. All temporary borrowing is due to be repaid by the end of the financial year.

5. Borrowing & Debt Rescheduling Position to 31st December 2017 - Comparison with Strategy

5.1. The Strategy for 2017/18 stated that new borrowing would be undertaken in all periods with the aim of achieving an even spread of maturity profile and keeping an increase in the average cost of the Council's debt to a minimum. Borrowing would be undertaken at a time appropriate to coincide with an identified dip in borrowing rates available.

5.2. To date, no external debt has been taken or debt rescheduling undertaken and the Council's borrowing position at 31st December 2017 is as follows:

Borrowing Activity 2017/18	Maturing Debt £m	Debt To Fund Capital Expenditure £m	Total £m	% Cost
Opening Balance at 1.4.2017 New Borrowing to 31.12.2017 Borrowing Repaid to 31.12.2017	0.000 0.000 (14.000)	476.745 0.000 (1.354)	476.745 0.000 (15.354)	4.068%
Debt Rescheduling to 31.12.2017 -Borrowing Repaid -Borrowing Replaced	0.000 0.000	0.000 0.000	0.000 0.000	
Balance at 31.12.2017	**(14.000)**	**475.391**	**461.391**	**4.088%**
Projected Further Borrowing Required in 2017/18 (net of internal borrowing CF) Projected Further Borrowing Repayments –Actual -Voluntary	0.000 (0.000) (0.000)	1.969 (0.000) (1.794)	1.969 (0.000) (1.794)	
Projected Borrowing Position at 31.03.2018	**(14.000)**	**475.566**	**461.566**	
Authorised Limit For External Debt			583.007	

5.3. Internal borrowing is using internal balances instead of taking external borrowing to finance the capital programme. This strategy reduces interest rate risk (the risk of unexpected adverse changes in interest rate) and credit risk (the risk of default by counterparties to whom investments are made as investment exposure falls) and also provides a net saving in interest costs in the short term, provided that Council balances are sufficiently available to maintain this strategy. The balance of internal borrowing stood at £69.343m at 31st March 2017. A further £34.579m of internal borrowing will be made in 2017/18 to cover the 2016/17 carry forward of capital expenditure, making the total predicted internal borrowing balance for 2017/18 of £103.922m.

5.4. The Council's Capital Expenditure plans and Borrowing Requirement at 31st December 2017, from that originally agreed by full Council at its meeting on 24th February 2017 is shown below:

	Original Budget at 1/4/2017 £m	Position at 31/12/2017 after Carry Forwards/Rephasing
Net Capital Expenditure Programme 2017/18	49.444	45.295
Borrowing Requirement 2017/18	48.844	36.548

5.5. Total LOBO debt the Council has secured is still at £30m, well within the limit set in the strategy of 10% of total external debt (equating to £46m). A limit is set on this type of borrowing to limit the amount of variability within the debt portfolio of debt repayment. The average cost of the Council's LOBO debt is 3.93%.

5.6. No debt rescheduling activity of existing debt has taken place to 31st December 2017, due to all existing borrowing loans being in premium position. (Meaning that the coupon rate of existing debt is higher than the current market rate for equivalent outstanding periods and so a premium would be incurred to repay this debt back early).

5.7. Full Council, at its meeting on 24th February 2017, approved the Council's Prudential Indicators for 2017/18, set as a requirement of the Prudential Code to ensure the Council's capital financing, in particular its long term borrowing, is prudent, affordable and sustainable. It can be confirmed that no Prudential Indicator limits have been breached in the third quarter to 31st December 2017.

6. Other Treasury Management Issues

6.1. MiFID II (Markets in Financial Instruments Directive)

The Financial Conduct Authority (FCA) has issued the above Directive which comes into force on 3rd January 2018. It relates to the rules governing the relationship between investors and who they invest with and applies to regulated products such as Certificates of Deposit, Bonds and Money Market Funds.

The Council has met certain Qualitative and Quantitative tests to opt up to professional status where necessary with all its market participants to enable it to continue to invest in accordance with its Investments Strategy,

6.2. Proposed Changes to CIPFA Treasury Management Code and Prudential Code

CIPFA issued revised codes that govern Treasury Management in December 2017, following a recent consultation. The Codes were last updated in 2011. The new Codes will apply to and from Council's 2018/19 budgets. The prime reason of these revisions was to highlight the increased emergence of non-treasury investments held in other financial assets and property, primarily held for return by Councils. Such activity includes loans supporting service outcomes, investments in subsidiaries and investment property portfolios. CIPFA has emphasised that these investments, although not part of general treasury management activity, are the responsibility of the S151 Officer and should therefore be managed and subject to the same risk / return considerations as for treasury. Within the Codes, CIPFA recommend that details of these non-treasury investments will be included in an annual **Capital**

Strategy, which will also set out the Council's risk appetite and specific policies and governance arrangements for these non-treasury investments.

6.3. Proposed New DCLG Investment Code and MRP Code -Consultation

DCLG are proposing to update the statutory guidance on Minimum Revenue Provision and Local Authority Investment Activity. As with the CIPFA Codes, these were last updated in 2010/2012 and do not reflect changes to the regulatory environment. The aim is to make sure that the new codes reflect the increasingly complex business models for non-investment related activities being adopted and that risk exposure on all borrowing/investment decisions is being highlighted and understood. The new guidance is expected imminently and will apply from 2018/2019 onwards.

2. Conclusion

Base Rate was increased to 0.50% on 2/11/2017 and hence short term rates have risen gradually from this date. Long term rates end the period to 31st December 2017 at relatively the same level they started the year, with gradual fluctuations in between. The Council continues to outperform the investment benchmark by having a lengthy Weighted Average Maturity of 145 days. No external borrowing has been undertaken to date. The cost of the Councils borrowing at 31st December 2017 was 4.088% The Council's internal borrowing level stood at £69.343m at 31st March 2017 with £34.579m of internal borrowing being carried forward in 2017/18 along with capital expenditure and borrowing requirement underspends. Temporary borrowing of £31m was outstanding at 31st December 2017 taken to cover predicted liquidity shortfalls at a cost neutral level. MiFID II came into force on 3rd January 2018 and in response the Council has opted up to Professional Status to enable it to continue to invest in accordance with its investment strategy. Revisions to the CIPFA Treasury Management Code and Prudential Code were published in 2017. These will be effective from 2018/19 and pick up on the emergence of non-treasury investments undertaken by Councils. Revision of the Statutory Guidance on Minimum Revenue Provision and Local Authority Investments is also imminent by DCLG, to bring these up to date with the current operating environment.

3. Consultation

a) Have Risks and Impact Analysis been carried out??

Yes

b) Risks and Impact Analysis

Risk & Impact Analysis for Treasury Management forms TMP1 of the Treasury Management Practices, as required by the CIPFA Code of Practice 2011. A Risk Register which details the main risks for Treasury Management has been completed and is reviewed annually. Both the TMPs and the Risk Register are held in the Treasury Files held on IMP at County Offices.

4. Appendices

These are listed below and attached at the back of the report	
Appendix A	Authorised Lending List and Credit Rating Key.
Appendix B	Investment Analysis Review at December 2017 - Link Asset Services Ltd.

5. Background Papers

Document title	Where the document can be viewed
Treasury Management Strategy Statement and Annual Investment Strategy 2017/18 -20/3/2017	Lincolnshire County Council, Finance and Public Protection
Council Budget 2017/18 - 24/2/2017	Lincolnshire County Council, Finance and Public Protection

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